

Understanding Technical analysis for forex trading

In this 4 part series, we will try and understand the basics behind using technical analysis to trade the forex markets.

We will start with the

"Basics of Technical analysis", move on to

"Best times to trade this 24 hour market"; and then study 2 technical analysis tools which are very effective in trading this volatile market -

"Candlestick charts" and

"Divergence".

Best times to trade the forex market

The forex market is the largest financial market in the world, trading around \$3.1 trillion each day.

(Every three years, the Bank of International Settlements (BIS) surveys major Forex market participants and then creates a volume estimate based on the information gathered.)

The most recent BIS survey completed in 2007 yielded the estimated volume figure as \$3.1 trillion. (This figure represents an increase in volume of about 70% from the 2004 survey.)

The market is open 24 hours a day from 5pm EST on Sunday until 4pm EST Friday. This makes the spot FX market unique to any other market in the world, as trading is available 24-hours a day.

Some interesting facts.

According to the BIS, the \$3.2 trillion average daily volume is equivalent to:

- More than 10 times the average daily turnover of global equity markets.

Note: The average daily turnover of global equity markets is about \$280 billion (Source: World Federation of Exchanges aggregate 2006)

- More than 35 times the average daily turnover of the New York Stock Exchange.

Note: The average daily turnover of the New York Stock Exchange is about \$87 billion (Source: World Federation of Exchanges aggregate 2006)

- More than 10 times the world GDP.

Note: The World GDP is about \$48 trillion (Source: World Bank)

Trading zones

Somewhere around the world, a financial center is open for business, where banks and other institutions exchange currencies, every hour of the day and night with generally only minor gaps on the weekend. Essentially foreign exchange markets follow the sun around the world, giving traders the flexibility of determining their trading day.

The forex market can be split into three main regions: Australasia, Europe and North America.

Within each of these main areas there are several major financial centers. For example, Europe is comprised of major centers like London, Paris, Frankfurt and Zurich.

Each day of forex trading starts with the opening of the Australasia area, followed by Europe and then North American. As one region's markets close another opens, or has already opened, and continues to trade in the forex market.

Forex volatility

Since Forex is a highly dynamic market, with lots of price oscillations in a single minute, it allows traders to enter the market many times a day and pull some profit from these numbers of trades.

But this 24 hour market does not necessarily mean continuous volatility in the currencies. Most new traders often misinterpret the fact, that this market can be traded anytime during the working hours of the week.

While there is always a definite movement, traders ideally need an environment of volatility, which may not be present at all the given times.

If you want to find an appreciable number of profitable trades you need to enter the forex market at the best period of time, i.e., when the activity, the volume of transactions, is the highest.

Characteristics of the forex market.

- ❑ Forex is a 24 hour market. It starts from Sunday 5pm EST through Friday 4pm EST.
- ❑ Forex trading begins in New Zealand, followed by Australia, Asia, the Middle East, Europe, and America.
- ❑ The US & UK account for more than 50% of the market transactions.
- ❑ Nearly two-thirds of NY activity occurs in the morning hours while European markets are open.
- ❑ During each trading day, the total forex volume is determined by the number of markets that are open and the times each of these markets overlap one another.

Trading volume by geographical location

(Source: BIS Triennial Survey 2007)

One can see why London is considered to be the world's capital of Forex trading.

It has the largest turnover since it is home to many large banks and funds that are prominent players in the world of currencies.

Country	Share
UK	34.1%
US	16.6%
Switzerland	6.1%
Japan	6.0%
Singapore	5.8%
Hong Kong	4.4%
Australia	4.3%
France	3.0%
Germany	2.5%
Denmark	2.2%
Other	15.0%
Total	100%

Timings of the major market zones

- New York Market trade times: 8am-4pm EST
- Europe Market trade times: 2am-12Noon EST
- Tokyo Market trade times: 8pm-4am EST

Overlap of trading zones

Forex trading activity is heaviest when major markets overlap.

Currencies tend to be most active when the markets overlap.

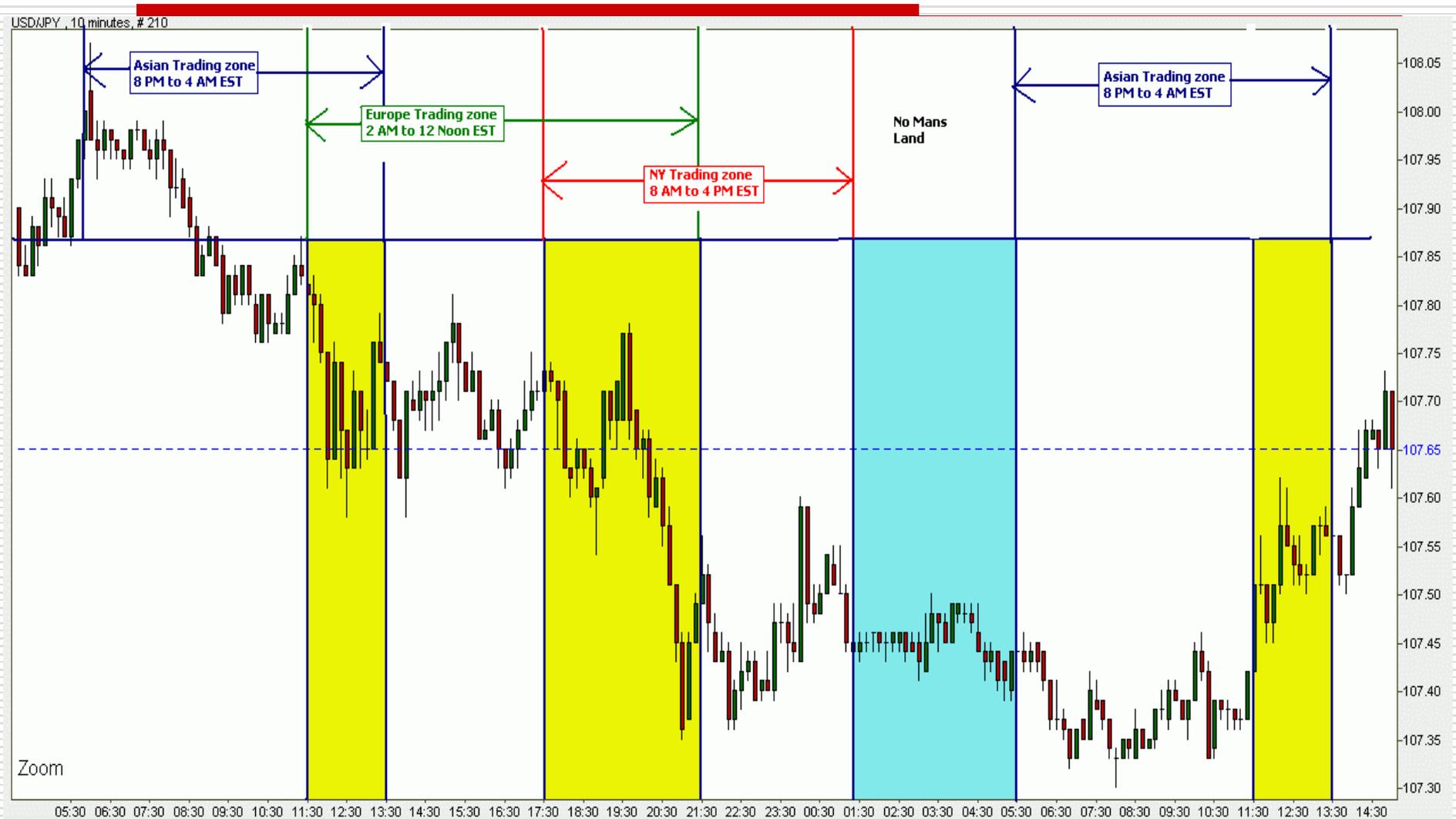
US/Europe Overlap:

8 AM - 12 PM (New York Time)

Europe/Asian Overlap:

2 AM - 4 AM (New York Time)

Overlap of trading zones



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Major market zones

Forex Major Market zones - Asia, Europe and USA. (Tokyo, London and New York)

Within each of these main areas there are several major financial centers.

For example, Asia is comprised of major centers like Australia, Tokyo, Hong Kong, Singapore etc.

Let us further look at the Major markets in detail –

Asian zone. (Tokyo trading session – 8.00PM to 4.00AM (EST))

- Tokyo is the first major market to open, and many large participants often use the trade momentum there as the benchmark to gauge market dynamics as well as to devise their trading strategies.
- Trading in Tokyo can be thin from time to time; large investment banks and hedge funds are known to use the Asian Session to run important stop and option barrier levels.

Asian zone. (Tokyo trading session – 8.00PM to 4.00AM (EST))

In this session, USD/JPY, AUD/USD, NZD/USD and their crosses provide good opportunities as liquidity and momentum remains supported from the previous US session into the relatively lighter Asian session.

But the major activity and subsequent liquidity is mostly concentrated in the British Pound based currency pairs – the GBP/JPY and the GBP/CHF. There is usually a lot of opportunity in trading these pairs after the 8PM EST open.

The USDJPY, GBPCHF and GBPJPY are good pairs to trade, as their broad ranges provide short-term traders with lucrative profit potentials, averaging app. 90 pips.

The GBPUSD and USDCHF are also good choices due to their moderate volatility as they help shield traders from irregular market movements due to intra-day speculative trades.

But the Euro based pairs (EURCHF, EURGBP and EURUSD) should be avoided until the London session when European traders anticipate the open.

European zone. (London trading session – 2.00AM to 12.00PM (EST))

London is the largest and most important dealing center in the world, with a market share of at least 30% and trading volume around \$580 billion.

Most of the dealing desks of large banks are located in London.

The majority of major FX transactions are completed during London hours due to the market's high liquidity and efficiency.

The vast number of market participants and their high transaction value makes London the most volatile FX market among all.

Traditionally a more volatile market, the London session is a good opportunity to transact in various GBP and EUR based currency pairs.

Currency pairs like GBPCHF, GBPJPY and GBPUSD present favorable trading opportunities.

The USDCHF, USDCAD, and EURUSD pairs also exhibit much activity.

But the volume of the JPY based pairs decline shortly after the overlap period ends, and should not be considered for momentum trades.

USA zone. (New York trading session – 8.00AM to 5.00PM (EST))

New York is the second most important market in FX, with approximately 16 % of market volume.

New York trading is very liquid.

In the United States spot market, the majority of deals are executed between 8AM and 12:00PM, when European traders are still active.

Trading often becomes quite choppy after midday however, as liquidity dries up. As a result, traders tend to pay less attention to market development in the afternoon.

NY is very much influenced by the US equity and bond markets and pairs will often move closely in tandem with the capital markets.

USA zone. (New York trading session – 8.00AM to 5.00PM (EST))

Offering the most possibilities, the New York session provides activity and liquidity in USDCHF, GBPUSD, USDCAD and EURUSD and subsequently most dollar based pairs.

Additionally GBPCHF and GBPJPY momentum spills over from the previous session and comprises a good percentage in New York.

But the EURGBP and EURCHF should be avoided as liquidity dissipates during the overlap and does not rekindle until the following London open. The thin market thus causes fluctuations that are unfavorable for the profit seeker.

Know your currencies

A trader will have a definite edge, if he/she is aware of -

The Average Pip range during certain times.

The Average Daily Range of the currencies.

The amplitude of the currency's movements spanning a daily 24 hour day (across the 3 major trading zones).

The day and time that the currency is expected to have high volatility.

The daily volume figures of the different currencies.

The average range

WHEN TO TRADE: Hours of the Day

Average range in pips for the four majors, Eastern Time:

HOUR	EUR/USD	GBP/USD	USD/CHF	USD/JPY
12 AM	10	11	15	14
1 AM	13	15	20	15
2 AM	21	25	30	20
3 AM	23	29	34	21
4 AM	20	27	29	20
5 AM	17	25	26	18
6 AM	17	24	26	18
7 AM	18	24	27	19
8 AM	26	31	39	25
9 AM	24	29	36	23
10 AM	30	34	45	26
11 AM	24	29	36	22
12 PM	20	25	31	19
1 PM	16	19	25	15
2 PM	16	18	24	15
3 PM	12	15	19	12
4 PM	9	11	14	10
5 PM	9	9	12	9
6 PM	8	9	12	11
7 PM	10	11	15	15
8 PM	11	11	16	17
9 PM	10	10	14	15
10 PM	10	12	16	13
11 PM	8	9	11	11

Active days and time

Gbp/Usd

31% of the trends occur on Thursday

39% of the trends occur between 0500-0900 EST

Eur/Usd

64% of the trends occur on Thursday & Friday

35% of the trends occur between 0500-1300 EST

Usd/Chf

45% of the trends occur on Thursday & Friday

61% of the trends occur between 0500-1300 EST

Usd/Jpy

41% of the trends occur on Wednesday & Thursday

51% of the trends occur between 0500-1300 EST

Gbp/Jpy

49% of the trends occur on Wednesday & Thursday

31% of the trends occur between 0100-1300 EST

Average Daily range

EUR/USD	111 pips	AUD/USD	85 pips
GBP/USD	156 pips	NZD/USD	81 pips
USD/CHF	127 pips	GBP/JPY	172 pips
USD/JPY	102 pips	GBP/CHF	161 pips

Break up of the daily volume

(Source: BIS Triennial Survey 2007)

Pair	Share
EUR/USD	27%
USD/JPY	13%
GBP/USD	12%
AUD/USD	6%
USD/CHF	5%
USD/CAD	4%
EUR/JPY	2%
EUR/GBP	2%
EUR/CHF	2%
Other	27%
Total	100%

Conclusion

Forex market volume of transactions remains high during the whole day, but peaks highest when the Asian market (including Australia & New Zealand), the European market and the U.S. market are open simultaneously.

In particular, there are two times when two of the major markets overlap during trading hours - between 2am and 4am EST (Asian/European) and between 8am to 12pm EST (European/N. American).

If you want to find a great number of profitable trades, focus on the hours when the markets tend to make their biggest moves, i.e., during these big markets overlaps, which therefore, are usually the Best Times to Trade.

Thank you

I hope this presentation can help you gain that extra 'Edge' over the market.

Visit my website for more educational and practical information on the correct use of technical analysis.

We don't just teach, but also implement the knowledge in the live market.

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