Better Planning And Correlations In The Forex Market

Firstly, I must point out the world market is fast changing, what works now may not be right for later, so please make your own study with your charts. Buying/selling patterns change however I believe this study should help you get a basic look of how certain currencies correlate. The goal is not overcomplicate but to document certain correlation patterns that occur and how you can use this information to your benefit. Follow-ups from others are welcome and feedback appreciated.

Also included in this document is some secondary research as well as our own research in this document. Please research for yourself on any secondary research from the given links and make your own mind up about any information they provide.

Currencies/commodities included:
USD,EUR,GBP,NZD,AUS,CAD,OIL,GOLD,JPY,CHF

USD
The dollar's importance in the currency market is unprecedented, therefore this currency will be analysed but we don't wish to delve too much into this, there are many studies and education available online on why the USD holds so much strength and effect on other currency pairs.

EUR.

The euro impacted mostly by any change in USD strength, having a 54% impact on it, meaning that any strengthening by the USD or weakening effects it greatly.

JPY
Seen as safe haven currency, often correlates with gold, Japanese want their currency weak too.

CHF
Also seen as a safe haven currency although many pro traders do not trade it anymore.

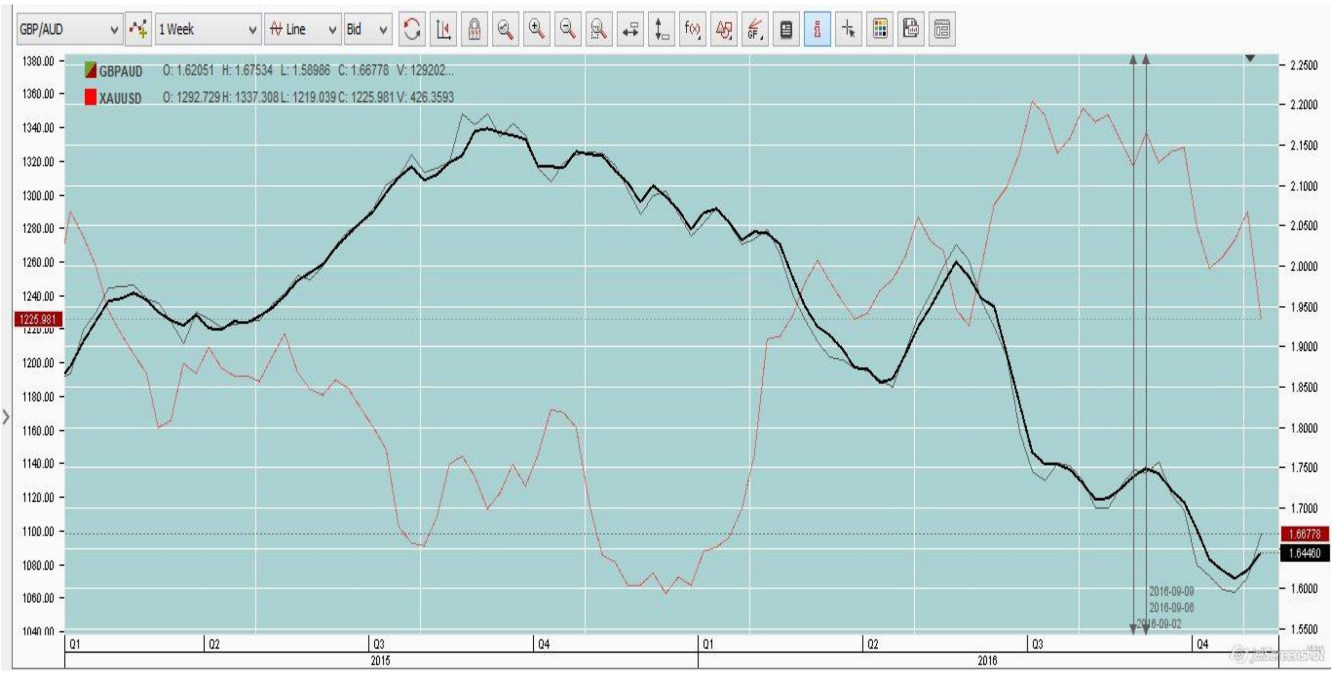
NZD
Known as a Commodity Pair, Aus and Cad also known as commodity pairs.

GOLD
Seen as the biggest safe haven instrument on the planet, when fear strikes the market, gold is heavily bought.

Objective of this Document

To help trader's understand correlations in Forex market and how they can plan for recovery trading and improve their day trading planning, short term traders can also learn something from this document, the fast changes are seen on the short term charts fastest.

GBPAUD/GOLD



As can be seen from the above weekly Line chart, gold and GBP/AUD are inversely correlated, not 100 percent of the time, but a good majority as seen on this chart, this is mainly due to the Aussie, Gold has an impact on it. We also know that gold and USD inversely correlated, so gold up, USD down, Aussies up GBP/AUD down, seem complicated? Well it is if we overcomplicate. What have we missed in this currency trail example? We have failed to look at the impact of any GBP strength or weakness.

(Check https://www.mataf.net/en/forex/tools/correlation for data)

> Top tip: Look at the impact of all currency on the pairs your trading and don't take a simple correlation as fact.

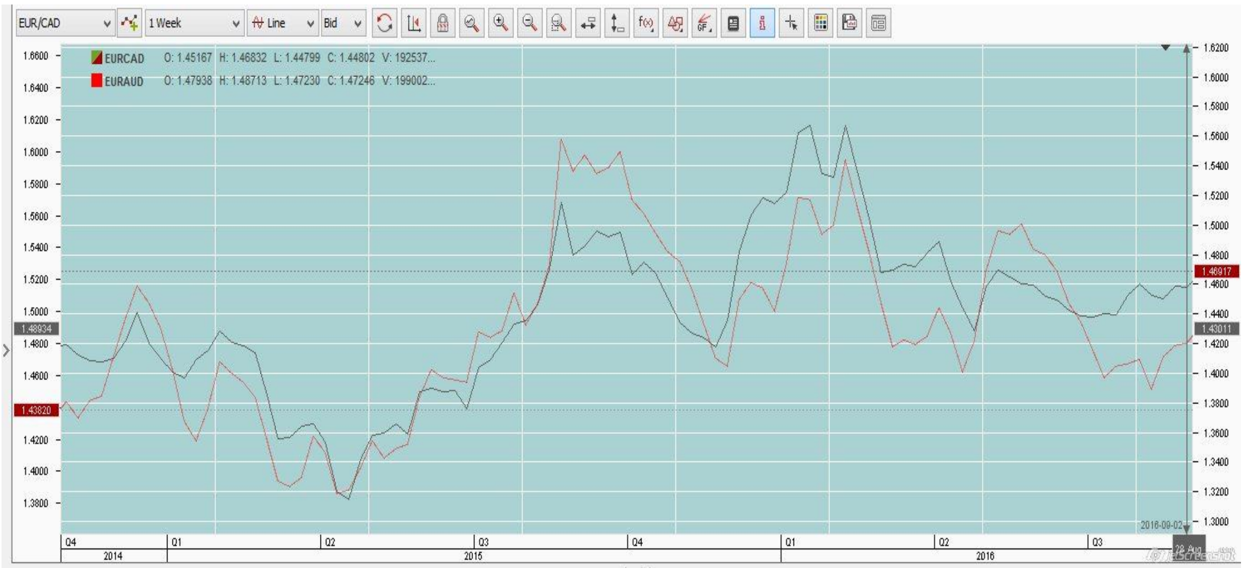
GBPNZD/GBPJPY

These two pairs correlating most of the time, however experienced trader’s will know that this can change due to the RISK ON/OFF Trade that occurs.

> Risk on/off
>
> This is a simple occurrence in the global markets, when investors feel their typical investments and markets are uncertain due to different factors, they invest into the JPY/GOLD/USD/CHF. Risk off: meaning, take less risk (conservative), risk on: meaning, take on normal market risk investments.

Suggestion when trading one of these two pairs, it is to read the potential of this occurrence in the markets and act accordingly, if a trader is in a loss situation on these pairs, the trader can decide to take the theme trade of the moment to mitigate his loss or risk. However if the trader is in situation of being in profit, the trader should consider taking profits and take the position on the other side.

EURCAD/ EURAUD



EUR/CAD and EUR/AUD Are correlated to a high degree; if trading day charts and a loss is encountered in one of the pairs would it be intelligent decision taking the reverse trade in the other pair as a recovery trade?

Or would it be better to wait for another trade setup to take place on one of the two above pairs and double risk on the next trade?

Or carry on trading as normal, take the loss and move on. Take the next setup with the same risk, etc.

3 options.
As a trader myself, I need to test where it would be optimum to use one of the three strategies. Below I go through some trading scenarios that I would consider appropriate for employing any of the strategies above.

Case A
In preplanning on the weekend, EURAUD, was the trade selected, trend was good, setup excellent, I also identified that the CAD was weak, so when the EURAUD short (sell) Trade lost, I selected to (immediate reverse trade) buy the EURCAD for twice the risk to go with the Bullish Euro momentum and capitalize on cad weakness.

The case above, In my plan I would feel that this is sensible position and plan in this case. Further testing needed to conclude. The three cases are to get traders mind's working in the right direction, to see ideas, dismiss them and/or take them, test them and then use them.

Case B
Day trade taken, day trade loses. Trader drops to the 4hr chart, finds optimum setup, long or short. According to his/her plan, H4 Trade is taken in either the EUR/AUD EUR/CAD and the same is done as in Case A, trade is taken with twice the risk to recover losses on first trade, H4 Trade is then changed and managed as a day trade when/if it is right to do so. Trade closed when recovery is complete.

Why drop to the H4 chart, firstly H4 Trade is in the plan, setup must be optimum, but another benefit of H4 Trade as a recovery trade is that the Stop loss is much smaller than on a day chart so therefore is second recovery trade is lost, total loss is smaller.

Case C.
In this case, we don't need a scenario, but the explanation and understanding is that if both recovery strategies mentioned in Case A/B is not appropriate then we must continue our trading as normal. Any recovery trade is always planned beforehand not undertaken as a panic strategy. Stay focused and keep emotions intact.

Plan A Plan B Plan C

Oil/USDCAD

(Oil takes a dive)

Cad is the most impacted currency by oil fluctuations nevertheless the oil influence is not always so impactful, especially in recent weeks, (13/11/2016) sometimes the economic outlook is so poor that any increase in oil is not seen as a major change to the economy outlook in Canada.
However this is still a very useful correlation in the forex market, when oil takes a new push higher in price , cad usually gains some strength.

The reason the above correlation is mentioned is far too many traders do not consider looking at and analysing oil in the process of trading USD/CAD and the cad pairs, it can be very beneficial to include as part of your planning, as well as to trade it to mitigate any risk take on Cad Pairs. Oil generally has good moves and can be traded on H4 swing. **We do not Recommending holding oil trades over the weekend**

<u>Hedging When In Profit.</u>

This is an idea that most don't associate hedging with, normally hedging is used as crisis management tool or loss limiting method or even as a recovery method, but in this case we suggest using it as a tool to protect profits in a view of possibly making more.

Trader is long, coming into resistance in the market, let's say in this case we also had confluence, this was also the monthly open. So two things could occur here, we bounce off back into the range or break higher, the trader decides to hedge fully for protection of profits initially.

Now the trader get the break their looking for, strong with momentum, you remove the hedge and let profits run with the break point (slightly under) as your profit trail. Now you have support for market to test and support for your trade.

(Please test this idea before going live it.)

Trading currency groups

"I have my own reasons why I have 16 pairs in my watch list. I group those 16 pairs into 4 groups. In any one week, I can trade up to 5 pairs at the same time. I avoid putting "all my eggs in one basket", simple disciplinary rule.

Some of the pairs are correlated or inverse-correlated, so I would avoid opening trades in the pair which are correlated to mitigate potential drawdown and losses." Quoting Emmanuel7788

Group 1/USD

AUDUSD
EURUSD
GBPUSD
NZDUSD
USDCAD

Groups 2/EUR

EURAUD
EURNZD
EURCAD
EURGBP

Group 3/GBP

GBPAUD

GBPNZD
GBPCAD

Group 4/JPY
USDJPY
AUDJPY
EURJPY
GBPJPY

"When I trade EURAUD, I avoid GBPAUD and look at EURGBP for market type/direction.
Similarly when I trade GBPNZD, I avoid EURNZD.
When you see weaker AUD and strong EUR, you pick to buy EURAUD... as an example.
When USD is strong, you basically can trade any of the pairs in the 1st group" Emmanuel7788

From the above I can see that it is critically important to analyse the 4 majors USD/GBP/JPY/EUR for good success in day trading and planning. Also to trade off against the strongest/weakest of NZD/AUD/CAD Meaning to identify the potentially strongest and weakest of these three pairs, As well the optimum opportunities in All pairs relating to the big four (USD/GBP/JPY/EUR).

Also consider spreading risk among these groups, so if trading Potential NZD Weakness (Do not select to trade eurnzd, gbpnzd, nzdusd, nzdjpy from the four groups at once.).

Recovery Trading.

According to my understanding of Craig Harris, there are 3 distinct methods to handle recovery.

1. During the London session, you *may* SAR (stop-and-reverse), while doubling your trade size.

2. During any session other than London, you should not SAR. You *may*, after taking the stop loss, wait for the next valid trade setup and enter at double your normal trade size.

3. At all times, it is perfectly acceptable to take the loss and watch for the next valid trade setup. Enter at the normal size, no doubling up.

I'd recommend working your way up from recovery method 3 to 2 to (entirely optional) 1.

Please note two key distinctions between methods 1 and 2.

Recovery method 1 *instantly* gets you in, in an *opposite* direction of the trade stopped out at the moment of 2nd, recovery entry: long trade stop loss, instantly followed by a short trade recovery entry at double the original size, Long --> Short x2; or Short -->

Long x2.

By contrast, recovery method 2 *eventually* gets you in, usually (but not always!) in the *same* direction as the the most recent trade stopped out: Long --...--> Long x2; or Short --...--> Short x2.

Recovery Rule 1.
With either recovery method 1 or 2, go back to your normal trade size on trade 3, the first post-recovery trade... regardless of the outcome of trade 2, the recovery trade. Otherwise, you've entered the land of the martingale, from which few brave souls ever return alive...

Recovery Rule 2.
With either recovery method 1 or 2, it's especially critical to employ proper MM. Your standard trade size must be small enough to allow for conceivably taking 3 times your typical loss, after 2 trades, in a given currency pair. Otherwise, you'd be much better off sticking to recovery method 3.

Recovery Rule 3.
With either recovery method 1 or 2, no need to get greedy. Once the recovery trade is showing unrealized profit of a bit more than *half* the number of pips lost on the previous (stop loss) trade, you'd better have some pretty compelling reasons not to TP in full. Save scaling out / adjusting stop loss techniques for normal, non-recovery trades.

The above is from craig harris thread. They are ideas and thoughts on recovery which traders can test and where some of the ideas shared in this document are found. We suggest reading it in full to get the right understanding

Disclaimer: We Bare No responsibility on any method your undertake in your trading and any losses you undertake, you must find what is suitable for your trading and test it yourself before applying in live market conditions. Written by ensale

Notes

One other feature of the USD that is important for novices in forex to understand is that the dollar is used as the standard currency for most commodities, such as crude oil and precious metals. So what's important to understand is that these commodities are subject to not only fluctuations in value due to the basic economic principals of supply and demand but also the relative value of the U.S. dollar, with prices highly sensitive to inflation and U.S. interest rates, which directly affect the dollar's value.

Read more at

The 6 Most-Traded Currencies And Why They're So Popular | Investopedia http://www.investopedia.com/articles/forex/11/popular-currencies-and-why-theyre-traded.asp#ixzz4PEE71lfz