



Day Trading Forex

by Joe Ross



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INTRODUCTION

It is said that to be a successful FX trader, you have to read and research. You need to get a basic Forex education as a foundation.

I agree with that statement if you are going to position or swing trade forex on perhaps an hourly or longer-term chart.

However, trading from 30-minutes down to 1-minute charts does not require you to know much else other than what is going on at the moment.

This is a manual about day trading forex, meaning you are in and out in a very short time. Since forex markets don't really have a "day," and are open around the clock, perhaps I should call this manual "very short-term forex trading."

This is not a manual for raw beginners. If you need to know the basics of forex trading, I urge you to check out www.babypips.com. There you will get a decent free education, which will prepare you for the contents of this manual. My purpose here is to teach you how to trade forex without getting yourself into a mess of trouble. In this manual, you will find the essential understanding of how prices move and how to trade the various situations that you see on the price chart that is live and moving right before your eyes.

I will not be talking about brokers and which ones you should use, so please don't ask. Also, don't ask me if you can make a living trading. I make a living trading, traders on the staff here at [Trading Educators](http://TradingEducators.com) make a living trading, we have countless students who make a living trading, but I cannot know if you can make a living trading. In fact, I have no idea what a living is for you!

There are many forex scams, but it is up to you to research what those are. My word to you is "beware." It's your job to find reputable forex dealers. One word of caution — just because a broker is registered with the CFTC or the NFA doesn't mean they are not crooks. Forex is a virtually unregulated venue. The only requirement, at the time I am writing this, is that the CFTC and the NFA require brokers to show they have enough money to satisfy the minimum amount of margin they will allow a trader to use. You can find out which firms are exceeding industry standards by visiting the regulator's sites: www.nfa.futures.org, and www.cftc.gov. In the Appendix at the end of this manual I discuss the differences between forex and futures. These are important for you to know.



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CHAPTER 1

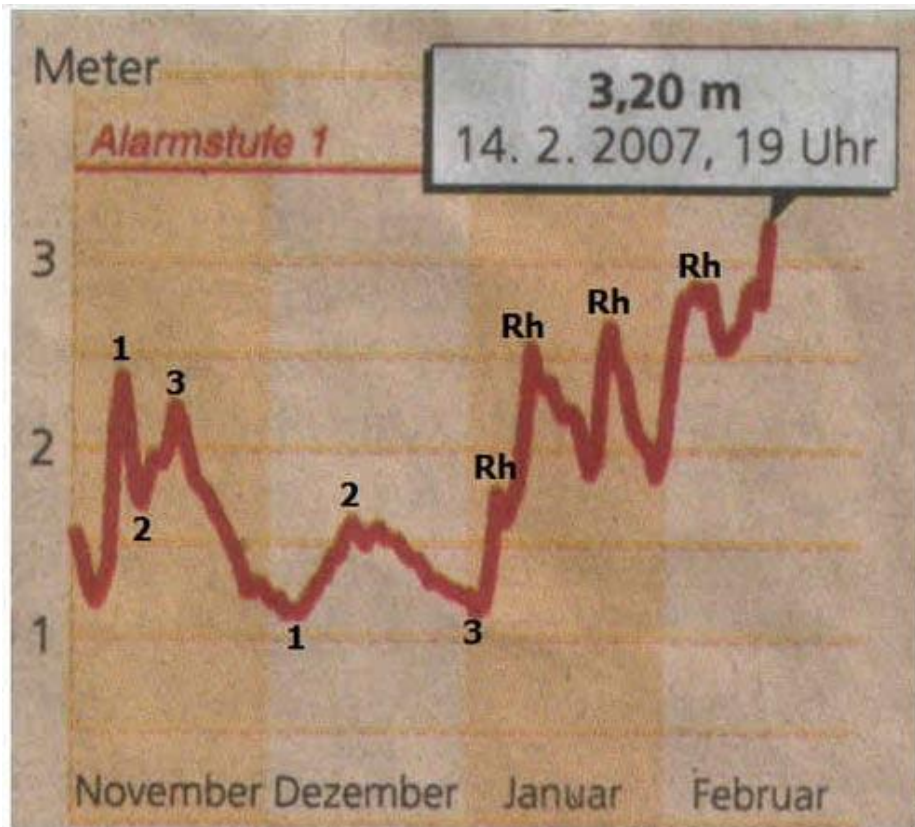
The Law of Charts (TLOC)

All price action follows a law. At Trading Educators we call that law "The Law of Charts" (TLOC).

It doesn't matter what it is you trade, whether it is forex, futures, stocks, bonds, or CFDs, the charts you see on your screen will follow TLOC. It doesn't matter which time frame you trade, the charts you see on your screen will follow TLOC.

TLOC reveals to you, in graphic form, human emotional reaction to the movement of price. Prices have a range of values; there is a high and a low. The distance from the high to the low is the "range." If you subtract the low from the high, the arithmetic difference is "volatility."

If TLOC is true, anything that has a range of values should produce something that looks like a chart of prices. Let's see if that is so.



Here is a chart of water levels in the Elbe River in Germany. For the moment, ignore the 1-2-3s and the Rh's. We'll get to those soon enough.

The formations you see here have a driving force that causes the chart to appear in such a way that it is obvious that the Elbe River is deeper at the point of measurement in February (Februar) than it is on the first of January (Januar). What is the driving force? The total of rainfall, snow melt, and output from any underground springs and feeder streams into the Elbe: minus the amount of water being taken out of the river for a variety of uses. The point is that the river has a range of values for its depth, from low to high.

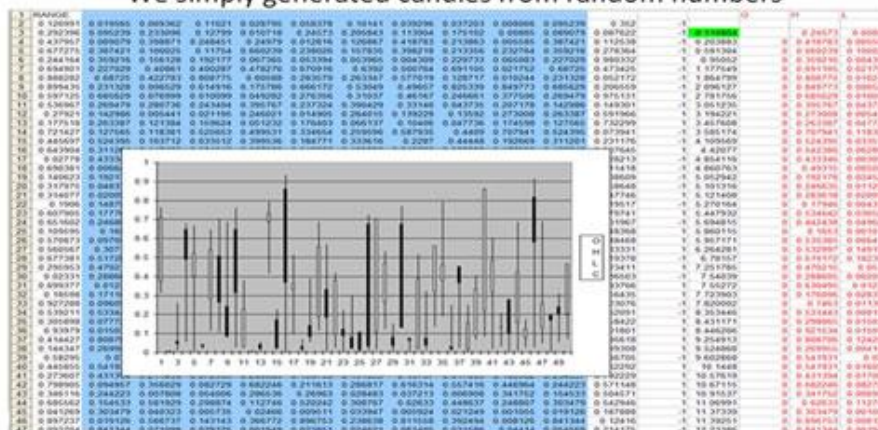
Let's look at another chart.



This looks like a candlestick chart of a currency pair — it could be any currency, and it could represent any time frame. Unless someone tells us, we have no idea of what this chart represents. Is it tradable? No. It's not tradable at present, because there is no market for what the chart represents. What is it that we are looking at? The chart shows us a range of values produced by a random number generator! The driving force behind this chart is a random number generator. In case you find this hard to believe, take a look at how this chart was produced.

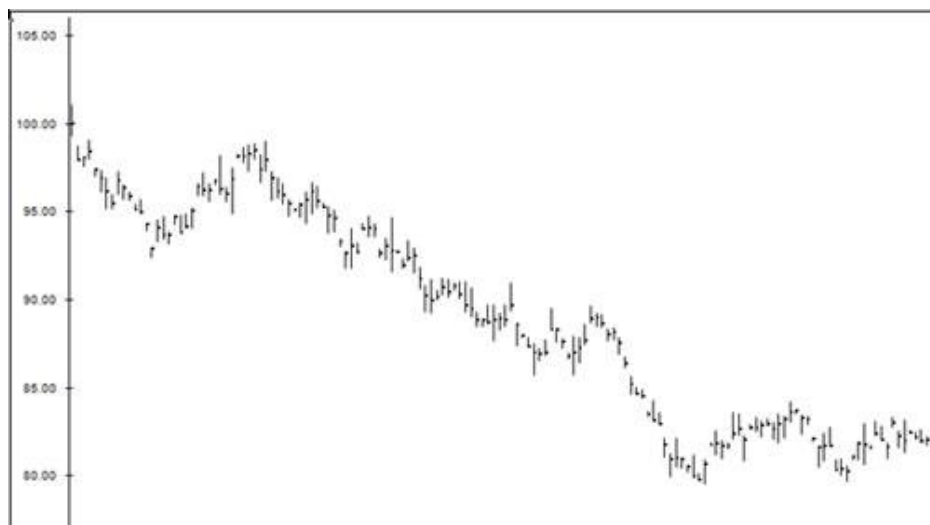
THE LAW BEHIND MARKET DYNAMICS

We simply generated candles from random numbers



Interesting, isn't it?

Let's look at one more chart. It's a chart like the ones they used to have before the exchanges allowed you to see the open — a "high-low-close" chart.



Are you wondering what in the world this chart could represent? What you see is a chart of coin flips — heads or tails. Again, there is no market in which you could trade this chart, but it's interesting to see that it has a range of values, and therefore follows TLOC.

What about a chart of prices? What drives the formations we see on a chart of stock, futures, or forex prices?

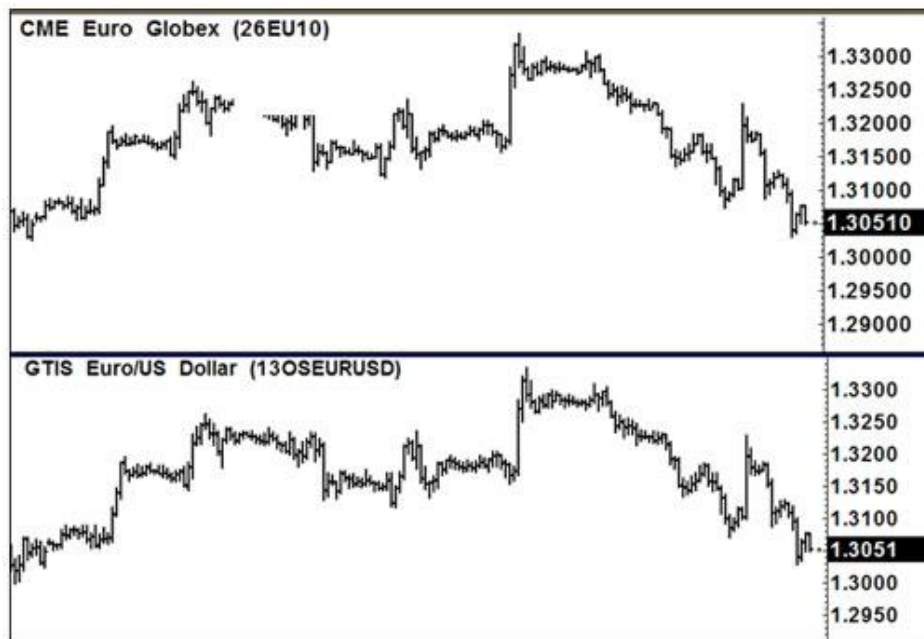


This is a weekly chart of the currency pair USD/NOK. However, I could have removed the price scale and told you that it represented a 15-minute soybean chart, and you would not have known the difference. All of which brings up a point — a chart is a chart, is a chart. Unless you know what the chart represents, all you would be seeing would be a graphical representation of something that has a range of values. Are you with me? Do you see the truth in TLOC?

As mentioned previously, the impetus (driving force) behind the chart of a forex pair is human emotional reaction to the movement of price: fear, greed, pride, anger, guilt, and others.

So what do we do about those formations, and how do we trade them? Can we make money by understanding what they are?

In the next chapter we begin to identify the formations, and following that we will look at how to trade them. But before we go, I want to show you one more graphic.



The top chart shows you the euro FX traded in US dollars, as a futures contract at the Chicago Mercantile Exchange. The lower chart show you EUR/USD traded in the spot forex market.

Never, ever, let anyone tell you that you can't trade the major, and even some of the minor currencies in the futures markets, or that forex is somehow better than futures. It is not. Each has its own advantages, and one of the main advantages of futures is that they are highly regulated.

Nevertheless, this is a manual about trading in the forex markets, so please excuse me if I wandered a bit.



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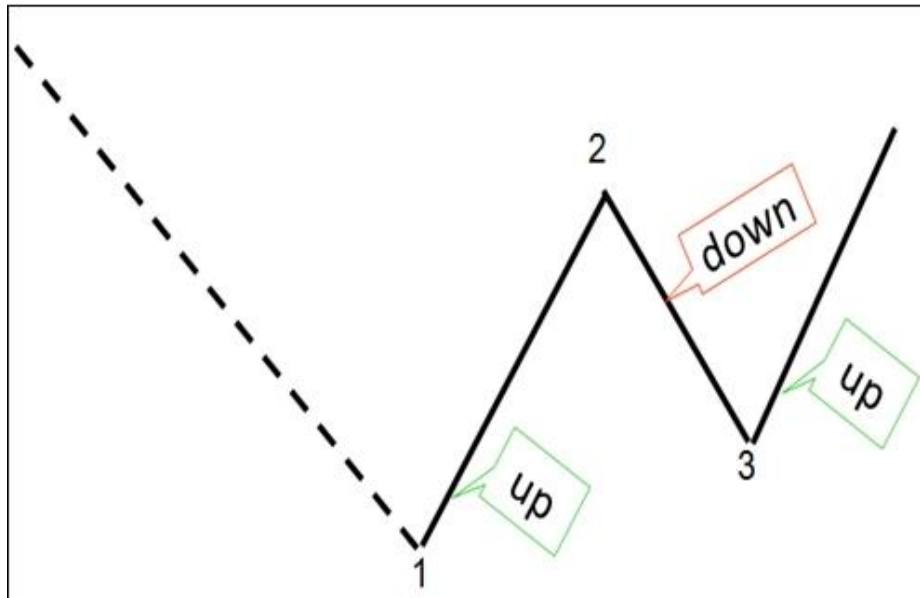
CHAPTER 2

The Law of Charts (TLOC) formations

The 1-2-3 low formation



A 1-2-3 low formation consists of a leg up, a leg down, and a leg up:



Let's assume prices are moving down; they are making lower highs and lower lows, which is the definition of a downtrend.



As prices move down, each of the bars is potentially the end of the down move. When we are trading, we have no idea which one it will be.

If we look at the chart below, we see the beginnings of a 1-2-3 formation in which the #3 point never fully materialized.



This brings us to the definition of a 1-2-3 low. The #1 point must be the lowest low at the end of a trend or swing. Additionally, we must have both a higher low and a higher high following the #1 point, which in the case above was accomplished with a combination of two bars (↔↗). There can be any number of bars between the #1 and #2 points.

The requirement for a #2 point is that there must be one or a combination of two bars in sequence that make both a lower high and a lower low following the #2 point. In the chart above this was accomplished by a single inside bar (↖↘), the bar following the #2 point.

However, in the case above, once prices moved equal to or lower than the #1 point (↔↘), a #3 point never materialized. A #3 point can never be equal to or lower than the #1 point.

The requirements for a #3 point are seen on the next chart, one we've previously seen.



Following the establishment of the #2 point of a 1-2-3 low formation, there can be no more than 3 bars of correction before prices begin moving higher. To create the #3 point, there must be one or a combination of two bars in sequence having a higher low and a higher high. In the case of the chart above, it took only one bar (↗↗) making a higher low and a higher high to establish the #3 point. Note: Some currency pairs will frequently make four bars of correction between the #2 and #3 points. If through testing and experience you find that to be true, by all means use four bars. However, beyond four bars of correction, probabilities favor sideways movement of price, and the momentum needed to gain a profitable number of pips is lost.

The chart above shows the smallest possible combination of price bars needed to create the 1-2-3 low formation. There are other ways to form the 1-2-3 formation. For instance, both the #1 and #2 points can be on the same bar. Also, the #2 and #3 points can occur on the same bar. I suggest ignoring those 1-2-3 low formations. It's much better to see and trade clearly defined 1-2-3 lows.

What causes 1-2-3 lows?



As prices decrease, there comes a point at which there are not enough sellers willing to sell at the lower prices.

As momentum for lessening prices begins to slow, traders begin to take profits by buying what they previously sold. Buyers, who have been waiting for a chance to get long, also enter. Prices then move from #1 to #2.

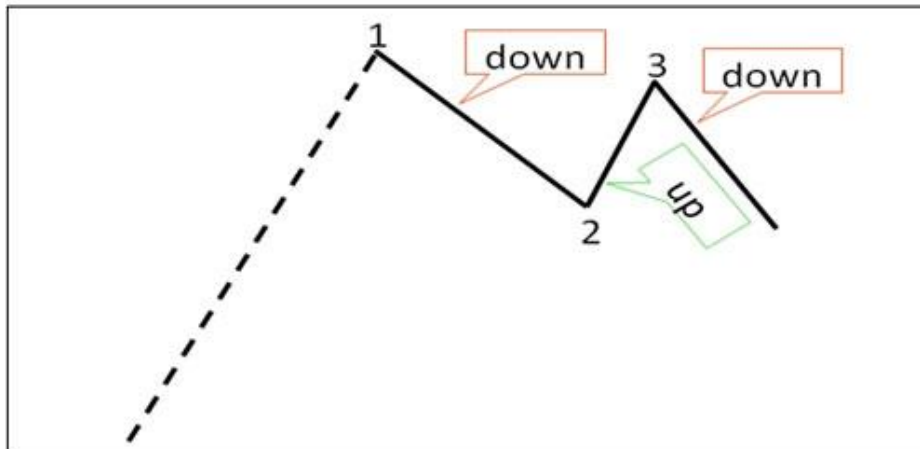
However, sellers who have been eager to participate in the downward move enter the market, and their selling begins to move prices from #2 to #3. Joining those sellers are short-term buyers who want to take quick profits when prices reach #2, and this helps in the move from #2 to #3.

Nevertheless, there is now more buying pressure in the market than there is selling pressure. The buying pressure comes from added buyers who see what's happening as an opportunity to get long. Adding to that buying are shorts who realize they really should take profits, as the down move might be ending. All the new buying and short covering cause prices to move strongly towards the #2 point, and usually prices will pass the #2 point, and a new trend is defined.

The 1-2-3 high formation

The 1-2-3 high formation is the flip- side of the 1-2-3 low formation. It comes at the end of a trend or swing in which prices have been moving higher. It consists of a leg down, a leg up and a leg down, as you will see on the next chart.

Whereas a 1-2-3 low signals a probable change in trend to the upside, the 1-2-3 high signals a probable change in trend to the downside. However, please realize that often the change in trend is a change to sideways action. Trends can be up, down, or sideways.



Let's assume prices are moving up; they are mostly making higher highs and higher lows, which is the simplest definition of an uptrend.



As prices move up, each of the bars is potentially the end of the move up. When we are trading, we have no idea which one it will be.

This brings us to the definition of a 1-2-3 high. The #1 point must be the highest high at the end of a trend or swing. Additionally, we must have one or a combination of two bars in sequence that make both a lower high and a lower low following the #1 point, which in the case above was accomplished by a single bar (↙). There can be any number of bars between the #1 and #2 points.

The requirements for a #3 point are met on the chart above, and repeated on the chart below.



The requirement for a #2 point is that there must be one or a combination of two bars in sequence that make both a higher high and a higher low following the #2 point. In the case above this was accomplished by a single bar (↙).

Following the establishment of the #2 point of a 1-2-3 high formation, there can be no more than 3 bars of correction before prices begin moving lower. To create the #3 point there must be one or a combination of two bars in sequence having both a lower low and a lower high. In the case of the chart above, it took only one bar making a lower low and a lower high to establish the #3 point (↘).

Note: Some currency pairs will frequently make four bars of correction between the #2 and #3 points. If through testing and experience you find that to be true, by all means use four bars. However, beyond four bars of correction, probabilities favor sideways movement of price, and the momentum needed to gain a profitable number of pips is lost.

There are other ways to form the 1-2-3 formation. For instance, both the #1 and #2 points can be on the same bar. Also, the #2 and #3 points can occur on the same bar. I suggest ignoring those 1-2-3 high formations. It's much better to see and trade clearly defined 1-2-3s.

What causes 1-2-3 highs?



As prices increase, there comes a point at which there are not enough buyers willing to pay the higher prices.

As willingness to pay higher prices begins to slow, traders begin to take profits by

selling what they previously bought. Prices then move from #1 to #2 on the chart. The selling at the #1 point is amplified by those sellers who have been waiting to get short.

However, buyers who have been eager to participate in the move upward enter the market, and their buying moves prices from #2 to #3. Adding to the buying at this point are short term sellers who buy back what they sold at #1, when prices reach what turns out to be #2.

Nevertheless, prices are now too high, and additional selling for purposes of taking profits, along with selling by those who would like to get short at these high prices, overcomes the late buying. Prices then begin moving towards or past the #2 point.



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CHAPTER 3

The Ross Hook

FOLLOWING A BREAKOUT OF

- The #2 point of a 1-2-3 high or a 1-2-3 low,
- Or the breakout of any kind of consolidation formation, the first failure of prices to continue to move in the direction of the breakout constitutes a Ross hook.



The first Rh we see represents the first failure of prices to move lower following a breakout of the #2 point of the 1-2-3 high. Once a Rh is in place, every subsequent failure of prices to move lower is also a Rh, until prices form a 1-2-3 low, or they move into a defined consolidation.

Every Rh is a potential #1 point for prices to begin to change direction.

That last Rh could rightfully have been labeled a #1 point. Let's see why.

This is the same chart as the one above, but in this case the Rh is labeled as #1.



Why is that formation a 1-2-3 low? It's because it meets the definition of a 1-2-3 low.

- The #1 point (also a Rh) comes at the end of a swing, or trend.
- Until the point labeled #2, there is no single bar or sequential combination of bars that make both a lower low and a lower high until the bar following the point labeled #2. It is the correction (red arrow) to #2 that causes #2 to be #2.
- We said that there is no limit to the number of bars possible between #1 and #2.
- Following #2 we have a lower high and a lower low on a single bar (red arrow).
- We move the #3 point to the lowest low following #2 as being a better place to mark #3.
- Following the point marked #3, we have a combination of two sequential bars that meet the requirement for a #3 point. First, we have a higher high (HH), followed by a higher low (LL).
- As probabilities dictate, the 1-2-3 is followed by beginnings of consolidation.

Is this a well-formed 1-2-3 low? Not really. Although there is no limit to the number of bars between #1 and #2, prices have used up a lot of momentum to reach the #2 point, and the #2 point places the move right into the middle of the former overall consolidation.

As we go through the remainder of the manual, I will be pointing out many small things that meet my requirements for entering and pursuing a trade.

In the next chapter we will be looking at various types of consolidation, but before we do, we need to see more examples of Ross hooks.

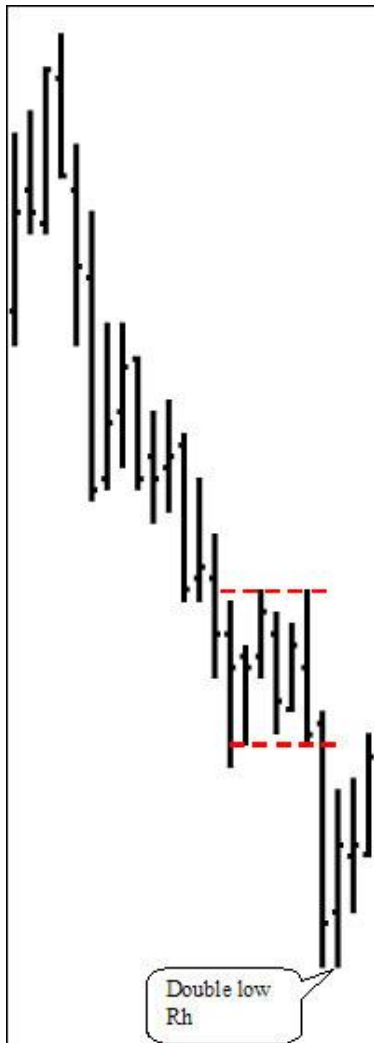


The first failure by prices to move lower after the breakout of a consolidation is a Ross hook. This particular consolidation is called "Congestion." We will define congestion in the next chapter.



A Ross hook is the first failure to move lower following the breakout of a consolidation we call a "Ledge."

We will look at some of these charts again when we define the various types of consolidation. Each



consolidation has certain characteristics, and over the years I have come to have very tight definitions of them.

When I trade, I want prices to set up exactly the way I want them. If not, I will let a trade go by.

One of the greatest lessons you will ever learn is how to recognize the trade that has your name written all over it.

You can't let impatience or greed tempt you to take trades that do not set up exactly in accordance with your trading plan.

There is lots of slop in the markets. Stay away from anything and everything that does not adhere to your specific considerations.

I let a lot of trades go by looking for the perfect setup. It has paid off tremendously with a very high win percent.

Now, let's get to those definitions of Consolidation, plus a few more basics beyond those, so that we can get down to actual trades.



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CHAPTER 4

Consolidation

The four consolidation formations:

Twenty-one or more overall sideways bars creates a trading range.

Eleven to twenty overall sideways bars forms a congestion.

Four to ten overall sideways bars that do not meet the definition of a ledge are called a cluster.

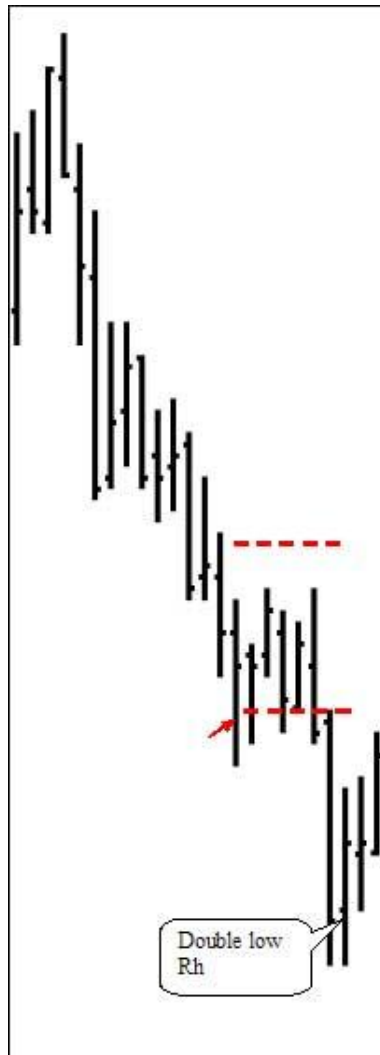
Four to ten overall sideways bars constitutes a ledge, which is further defined as having two matching highs or lows, with at least one bar separating the two matching lows and the two matching highs. Ledge breakouts are traded only in the direction of the former leg of a swing or in the direction of the former trend.

The chart on the left shows a ledge.

It has two matching highs, separated by at least one bar.

It has two matching lows, separated by at least one bar.

Since the prior trend was down, we trade



only a downside breakout of the ledge. We never trade an upside breakout of a ledge that was preceded by prices moving down. Of course, it's just the opposite for ledge breakouts when prices are moving up.

What causes a ledge to form? A ledge is a brief pause in the movement of prices during a trend or swing. It's an area of indecision or profit taking. A ledge always begins with a Ross hook (↗).



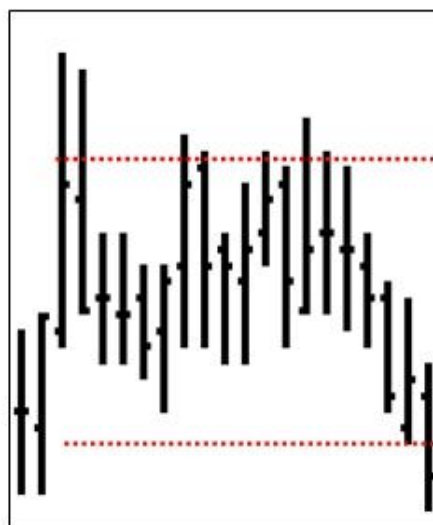
Why is the chart labeled as having a cluster and not a ledge? It's because, although there are two matching highs separated by at least one bar, there are no two matching lows. I've marked the overall cluster with a dotted line. When we get to the next chapter, "Identifying Consolidation," you'll see why I extended the upper and lower dotted lines to include the "inside" bar. Not counting the breakout bar, which opened in the cluster and closed almost in the cluster, there were actually seven bars in the cluster.

Next let's look at a consolidation pattern we call congestion. Just to remind you, congestion consists of 11 to 21 bars of overall sideways price action, without benefit of a breakout.

Why is the chart on the right considered to be in congestion?

The answer is that prices are overall moving sideways in a rather tight range. They have been moving that way for 17 bars, thus too many bars to be a ledge, and not enough bars to be a trading range.

In the next chapter we will look at ways to identify congestion. At that point I will repeat this chart, and you will be able to understand why I started the lines for the congestion where I did.



A trading range is any overall sideways action that has prices moving sideways for 21 or more bars.

The probability of a breakout from a trading range is greatest on bars 21 through 29.

A trading range might look like this:



At some point we have to say prices are no longer trending. Prices are moving sideways. What is that point? How can we identify that point? What does it look like? How can we tell that prices have stopped trending, and how can we tell when prices begin trending again? The answers to those questions come next.



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CHAPTER 5

Identifying Consolidation



We have defined congestion as having 11-20 bars. We begin our count by looking back to see which bar most typifies the vertical center of the congestion area.

To get a vertically centered line, we first measure from the top to the bottom of the congestion, add the high and low together, and divide the result by 2.

Once we have the vertically centered line, we begin our count by looking back to see which bar most typifies the vertical center of the congestion area.

Why do we want to count bars? Because the greatest probability for a breakout from congestion comes once the congestion changes into a trading range, and we achieve 21-29 bars.

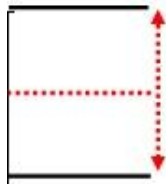
Additionally, the vertical center line aids us in the realization that we are indeed moving sideways.

We figure our vertical center line for trading ranges exactly as we did for congestion.



With the chart on the left, the breakout came on the 28th bar.

Most often, prices breakout of a trading range on bars 21-29 inclusive.



Trading ranges and congestions generally come at the end of a trend or leg of a swing in either direction. Statistics show that for most traders, consolidations are the least profitable times to trade forex. Still, breakouts from consolidation areas can offer some of the best times to trade.

Trading ranges and congestions at the end of a downtrend have been called "areas of accumulation." This term is a throwback to the days of commodity trading, but may well be accurate for currencies as well.



Trading ranges and congestions at the end of an uptrend have been termed "areas of distribution."

In forex trading, areas of accumulation and distribution last for similar amounts of time.

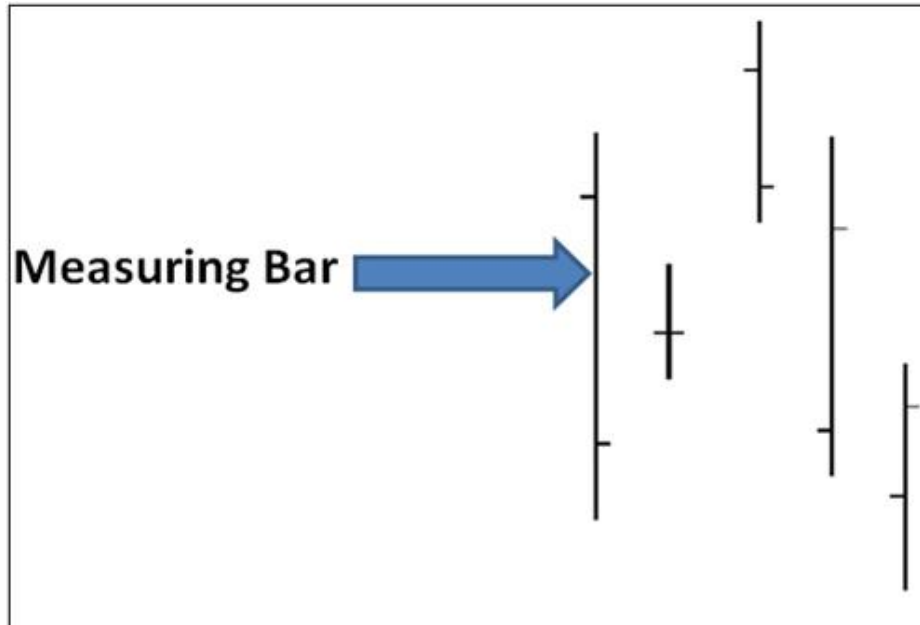
In forex trading, because you have one currency trading against another, prices tend to move up or down at the same rate of speed.

It's time now to become serious about identifying sideways markets.

One of the concepts every trader must learn is how to know when prices are moving sideways. There are rules for early discovery of this important price action.

One of the first ways to spot that prices are beginning to move sideways is that of what we call a measuring bar.

It looks like this:

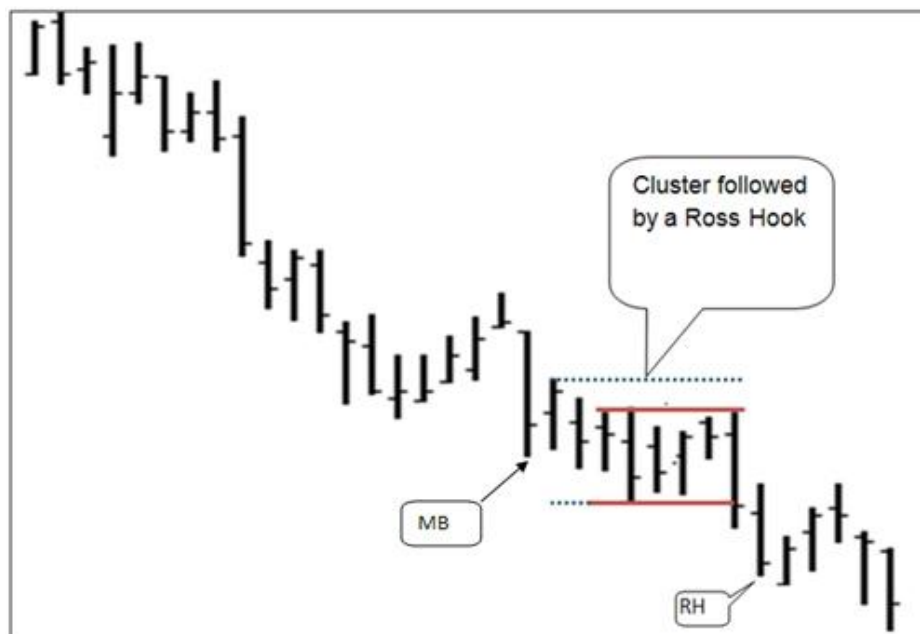


Anytime prices open or close on four consecutive bars within the confines of a “measuring bar,” you have consolidation. This is regardless of where the highs and lows of those bars may be located.

A measuring bar becomes such by virtue of its price range containing the opens or closes of at least four subsequent price bars. Notice that on the chart above, all four bars following the measuring bar have at least an open or a close within the range of the measuring bar. When you see that situation, it is time to expect sideways price action.

Consolidation can be very subtle in appearance. Often the difference between consolidation versus trend is the positioning of a single open or close. On the chart above, if the second bar after the measuring bar had closed above where it opened, those five bars would not have been considered to be in consolidation.

In the previous chapter I said: “When we get to the next chapter, “Identifying Consolidation,” you’ll see why I extended the upper and lower dotted lines to include the “inside” bar. Not counting the breakout bar, which opened in the cluster, and closed almost in the cluster, there were actually seven bars in the cluster.” Let’s look at that situation now.



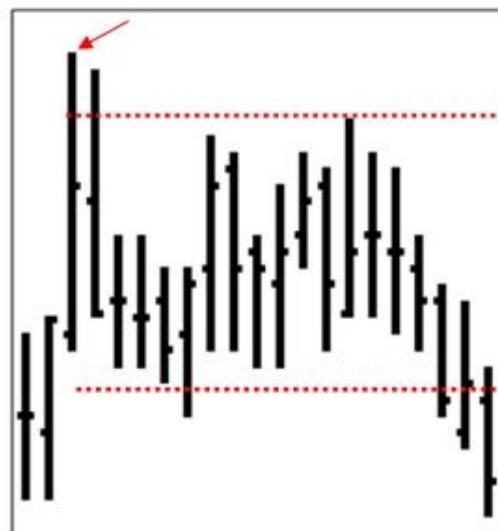
Do you see the measuring bar (MB)? The cluster began with the bar following the MB.

There are eight bars following the MB that have an open, a close, or both within the range of the MB.

In the previous chapter I also said: "In the next chapter we will look at ways to identify congestion. At that point I will repeat this chart and you will be able to understand why I started the lines for the congestion where I did."

We can look at that now, as well.

The reason was our good friend, the MB (↖)

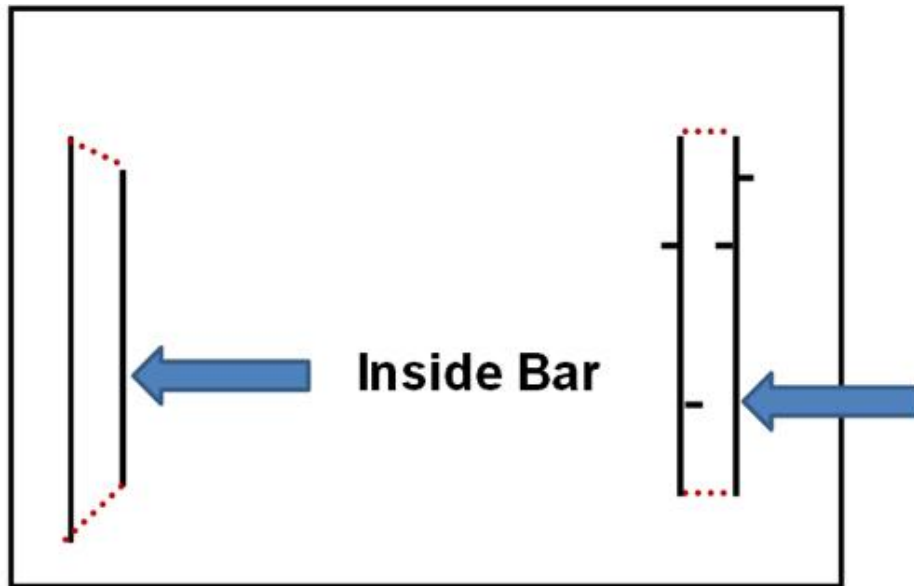


There are sixteen bars following the MB that have their open, close, or both within the range of the MB.

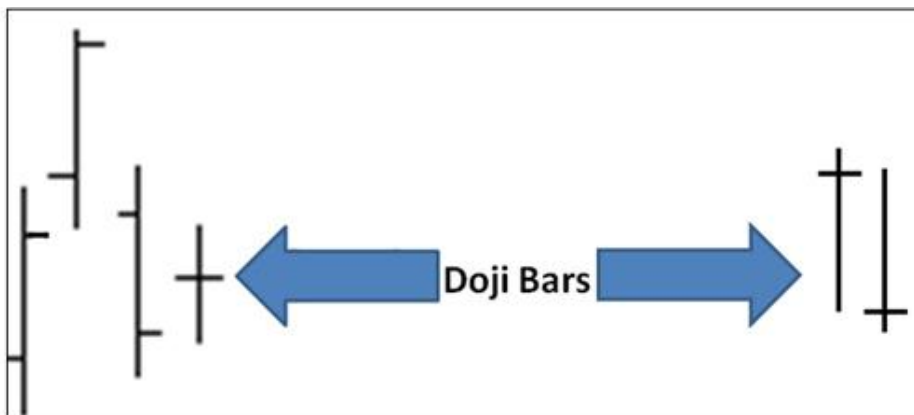
Consolidation by alternation

Anytime prices are not making consecutive higher highs and higher lows, or consecutive lower highs and lower lows, and you can see four alternating opens and closes, at times coupled with inside bars and at times coupled with doji bars, you are probably looking at the beginnings of consolidation.

For our purposes, inside bars can look like the ones below, and can have equal or unequal highs and lows.

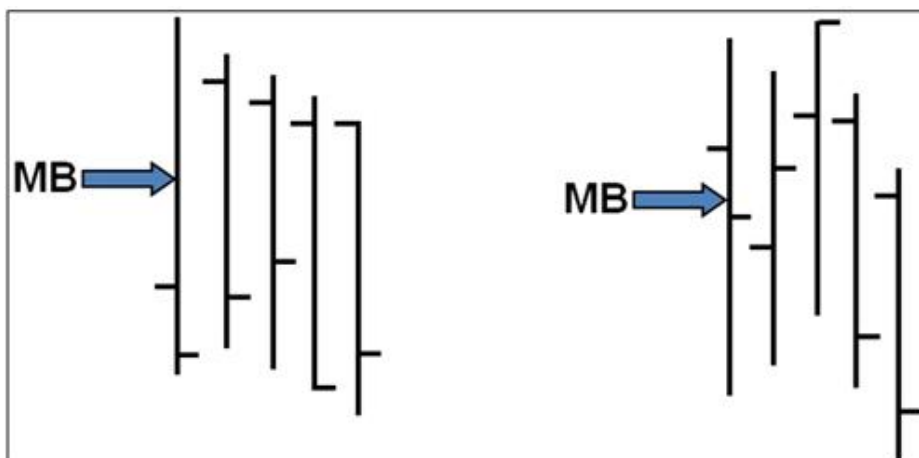


Doji bars look like these:



Consolidation by opens and closes:

If we have four consecutive closes or opens within the range of a measuring bar, prices are consolidating.

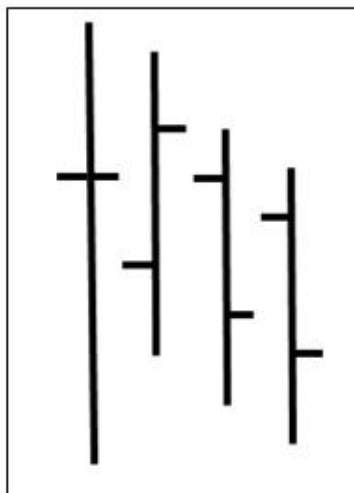
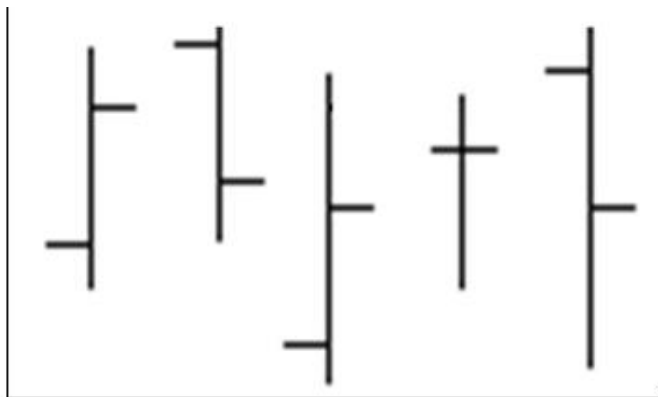


Here's another example of consolidation by alternation.
We call this congestion by high/low pairs.



With high/low pairs we see a series of four consecutive alternating close-lower than open; close-higher than open bars in any sequence.

Alternating bars are ones in which prices open lower and close higher on one bar, and open higher and close lower on the next. When you see it, begin suspecting sideways price action. The chart on the right shows alternating bars.



A combination of alternate closing high-low, low-high pairs is the beginning of consolidation. As you see on the left, a doji bar may be used as a wild card for alternating pairs. In this case we have 2 up bars and 2 down bars.

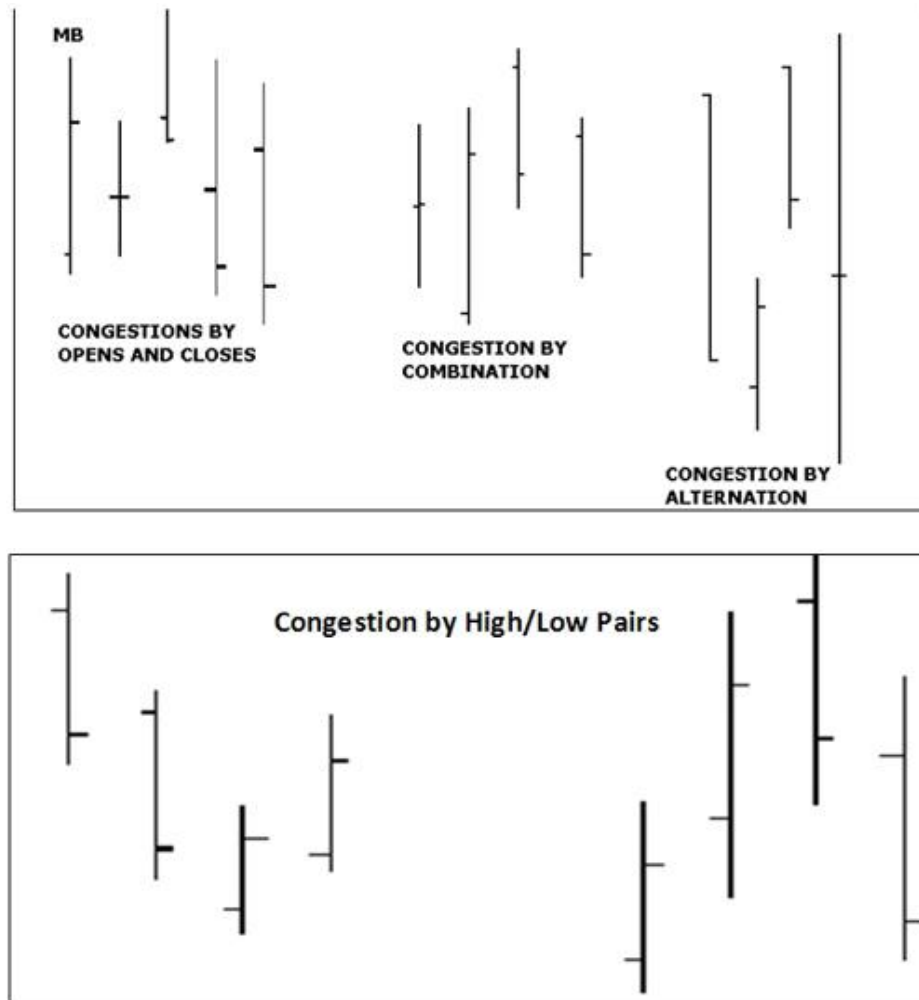
Consolidation by combination:

A series of four consecutive dojis, or at least one doji and any three alternating bars, is the beginning of sideways price action. Once again,

when you see a doji bar it can be used as a wild card to alternate with any other bar.

If there are three non-doji bars, one of them must alternate high to low. Keep in mind: as you look back, the first bar of a consolidation area may very well be the last bar of what had been a trend. The beginning of consolidation may look similar to any of the following, as long as it consists of four or more bars.

Here are more examples of patterns of consolidation:



Frequently, consolidation will start or end with a doji bar. Consolidation can also begin or end with a long bar move or a gap.

Another way to identify the beginnings of consolidation is when you see \wedge/\wedge or \vee/\vee on the chart. The smallest number of bars that can make up either of those formations is four.

As we end this chapter, I am pointing out some information that will become increasingly clear as we progress through this manual:

- Pointy places made when prices are in consolidation are not Ross

hooks unless they are preceded by a 1-2-3 formation.

- A 1-2-3 formation defines a trend, but it does not establish it. Therefore, if you see a 1-2-3 formation within a consolidation, it does not establish a trend, it only defines that one may be about to begin.
- Consolidation areas often have 1-2-3s in both directions. In fact, opposing 1-2-3 formations are typical of consolidation areas.
- If you see a 1-2-3 formation followed by a Ross hook, both within a consolidation area, be prepared to trade if the point of the Ross hook is violated.
- A violation of the #2 point of a 1-2-3 formation defines a trend; a violation of a Ross hook following a violation (breakout) of the #2 point establishes a trend.
- A violation of a consolidation area defines a trend. A violation of a Ross hook subsequent to the violation of a consolidation area establishes a trend.
- A 1-2-3 followed by a Ross hook is a setup for a tradable event.
- A consolidation breakout followed by a Ross hook is a setup for a tradable event.
- An established trend supersedes consolidation.
- The potential violation of a Ross hook using the Traders Trick Entry is a safe way to enter a trade while prices are in consolidation.

It's now time to look at the Traders Trick Entry.



Day Trading Forex

by Joe Ross



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CHAPTER 6

The Traders Trick Entry™

The purpose of the Traders Trick Entry (TTE) is to get us into a trade prior to entry by most other traders. Trading is a business in which the more knowledgeable have an advantage over the less knowledgeable. What we are trying to avoid by using the Traders Trick is the damage that can be done by a false breakout.

Typically there will be many orders grouped just beyond the #2 point of a 1-2-3 formation, or the point of a Ross hook. The insiders and market movers are very much aware of the grouping of orders at those points.

If they can make it happen, they will move prices to where they see the orders grouped together, and then a little past that point in order to liquidate as much of their own position as possible.

This action by the insiders is called "stop running."

Unless the pressure from the outsiders (us) is sufficient to carry prices to a new level, the breakout will prove to be false.

The Traders Trick (TTE) is designed to join the market makers and market movers as they move prices towards where they see order accumulations.

- When trading 1-2-3 and Ross hook formations, we want to get in ahead of the actual breakout of the #2 point or the point of the hook.
- If the breakout is real, the result can be significant profits.

- If the breakout is false, we will have at least covered our costs and taken some profit for making the trade.
- Those able to move prices will often create moves aimed at precisely those points where they realize orders are grouped.
- It is exactly that kind of engineering that makes the TTE possible.

In order for those able to move prices to be able to stop us from following their moves, they would have to stop the price action they are trying to create. You'll see why soon.

Correcting bars for TTE purposes are considered to be correcting as long as they make lower highs when prices are moving up and higher lows when prices are moving down. They don't need to make lower lows (↙).

- Once a #2 point is in place, we want to buy a violation of the high of any one of the correcting bars (↙↘↗) that form subsequent to the #2 point.
- We try them one at a time.
- As we'll see next, there must be sufficient room between our entry price and the #2 point for us to be able to cover costs and take at least some profit.



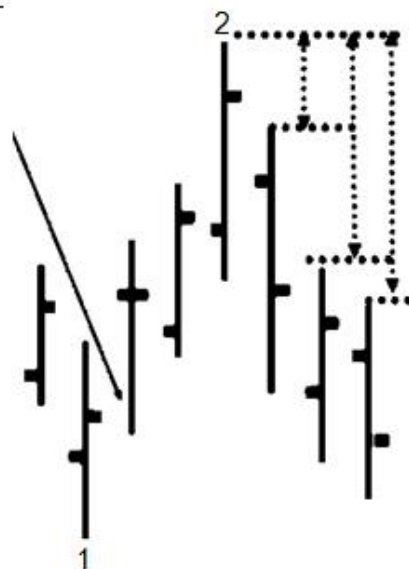
By insisting that there be enough room to cover costs and take some profit, we accomplish three things:

1. We get paid to trade.
2. If the breakout is false, we will still have had a winning trade and have traded for free.
3. The pressure is off.

The area between the first dashed line and the #2 point must allow enough room to cover costs and take a profit. If not, then the TTE may occur on any of the two price bars that follow, if there are additional bars.

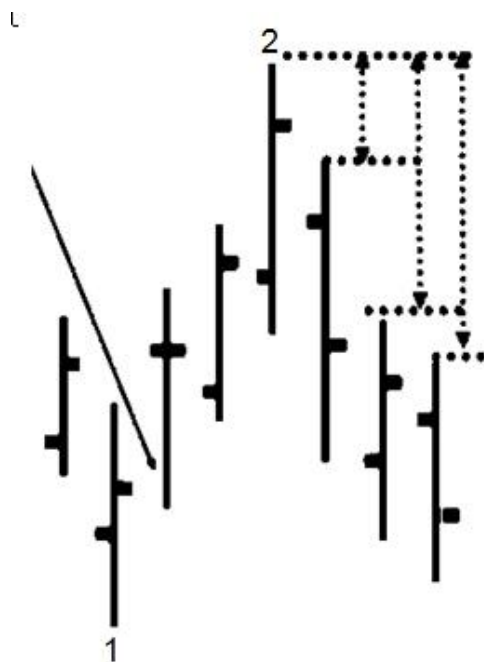
By covering costs and taking a profit

prior to prices reaching #2 we, in ^L effect, get a free trade.



If prices go on well beyond #2, we make a very profitable trade. This assumes trading a large enough position to be able take some profit.

A violation of the high of the first bar of correction gives the greatest percentage chance of the move continuing beyond the #2 point, but has the least chance of having room to cover costs and take a profit.



A violation of the high of the second bar of correction gives a lower percentage chance of the move continuing beyond the #2 point, but has a greater possibility of having room to cover costs and make a profit.

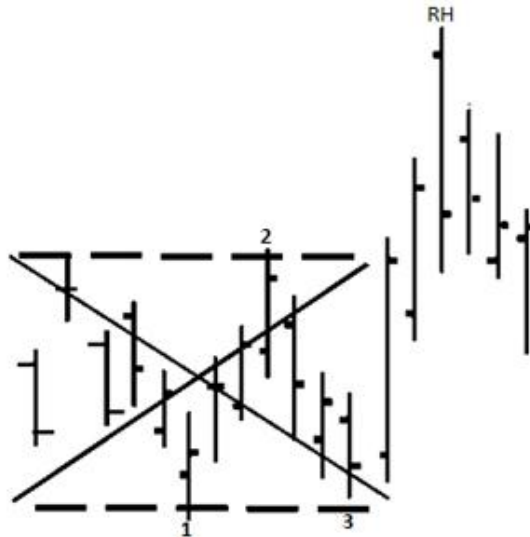
A violation of the high of the third bar of correction gives the lowest percentage chance of the move continuing beyond the #2 point, but has the greatest possibility of having room to cover costs and take a profit.

Beyond 3 bars of correction, the probabilities change in favor of consolidation. There is no reason to attempt the TTE when the probabilities favor consolidation as opposed to trend.

Reminder: If by testing, you have determined that the market and time

frame in which you trade typically makes 4 or more bars of correction, by all means allow 4 or more bars of correction. You want to trade reality, not some arbitrary rule.

Currencies and many stocks make more than 3 bar corrections. TEST to be sure!



The rules for trading the TTE ahead of a breakout of the #2 point of a 1-2-3 formation, and the rules for trading the TTE ahead of a breakout of the point of a Ross hook are identical. So whatever I say about TTE for trading the 1-2-3 formation is to be used for trading the TTE ahead of the breakout of a Ross hook.

Trading the TTE:

There are very simple rules involved with trading the TTE.

The 1-2-3 formation must not occur in consolidation.

The 1-2-3 formation must occur at the end of a trend or leg of a swing.

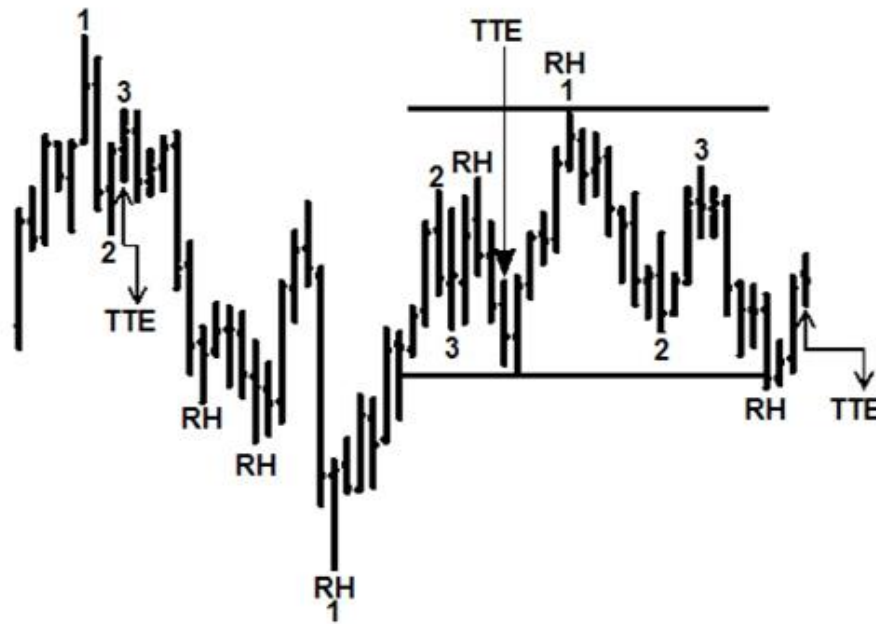
Note: 1-2-3 formations in consolidation areas are meaningless. Consolidation areas have them in both directions.

As soon as a #2 or Rh point is evident on the chart, prepare to enter an order one tick above (or below) the extreme of the correcting price bar (↙↘).

As prices move away from the #2 or Rh points, move your entry stop to one tick beyond the extreme of the correcting price bar (↙↘↙↘).

Although I've shown you upward movement of prices, the same rules apply

to downward movements of price from 1-2-3 highs, Ross hooks, and downside breakouts of ledges and consolidations.



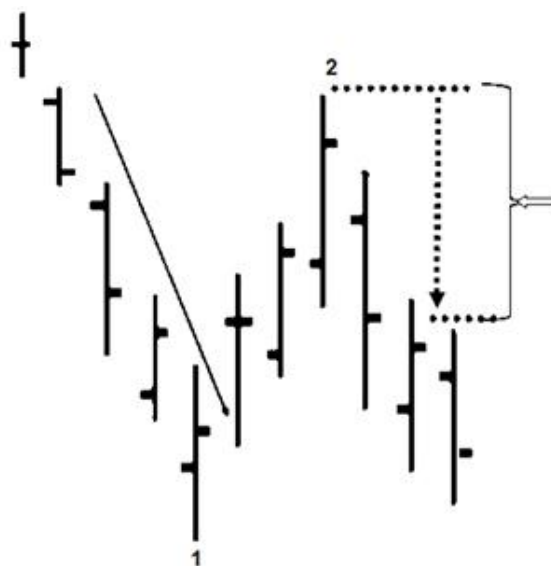
Every Traders Trick contains another trick. Let's look at that next. It is important because this is the way I actually trade.

I am basically a scalper when I day trade. My way of trading is to get in on high percentage setups, like the TTE, scalp for a set amount of money, and then get out. Over the years I have realized certain things about the TTE which have resulted in the TTE working for me a high percentage of the time.

- The first trick to using the TTE is to never take a breakout of the first bar of correction, regardless of how much room there is for taking a profit. Take only the second or third bar of correction, provided that they yield enough room for a profitable trade.
- When I say enough room, I mean that there is enough distance between the point of entry and the point of the #2 bar or the point of the Rh, to be able to take a scalp for the whole amount for the entire position. I will show later how to know how much money that will be.

I take all of my money at or before prices reach the #2 point. This has proven very effective for me, and it furnishes the level of comfort I require to trade successfully.

An alternative method is to take part of your money at or before prices reach the #2 point; then hang on in case you



get lucky and are able to trail a stop to even greater profits. You are the one who must make a choice between the two methods.

Now some final comments with regard to the TTE. You may recall that at the beginning of this chapter I said: "For those who are able to stop us from following their moves, they would have to stop the price action they are trying to create."

The reason for that can be summed up in a single word: "MOMENTUM."

The fact is, for those able to move prices to be able to stop us, they must stop their own momentum as they move prices towards the #2 point or the point of the Ross hook. The probabilities of that happening are low. You need to know why that is so.

There is a basic fundamental fact about all markets that a trader needs to understand.



That fact is why markets exist. There may be many reasons a market exists, but the supreme reason that reigns over all other reasons is that markets exist to fill orders.

To get your order filled is why you go to the market, any market, even the

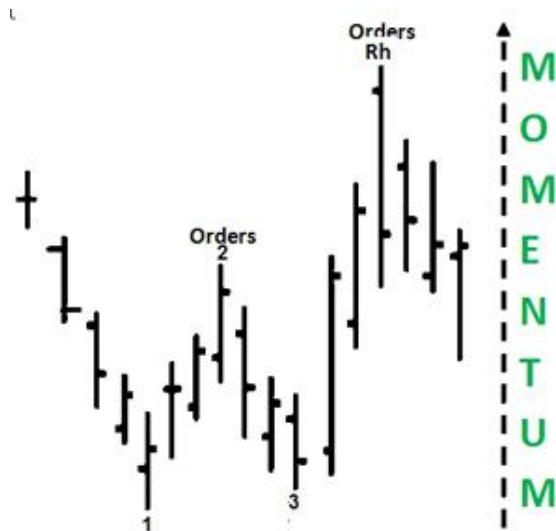
The entities whose self-proclaimed job it is to fill your orders are those entities we call "market movers." They make a fortune filling orders. They buy low and sell high and sell high and buy low. They do this virtually for free, whereas you have to pay the spread to accomplish the same thing. They can and do make a ton of money seeing to it that your orders are filled. Because they have virtually no costs, they can make money with movement of only a few pips. Because of their size, they can push prices up or down pretty much the way they want to.

Did you go? Are you back? Good! Let's continue.

When a market mover sees lots of orders grouped at a turning point, those orders become a tempting target for a run to fill those orders. You and I call such price action "stop running." We complain that the "dirty so-and-sos ran my stop." But from the point of view of the market mover, your order is being filled. Having your order filled is indicative of an efficient market, is it not?

Repeating what was already said: "The fact is, for those able to move prices to be able to stop us, they must stop their own momentum as they move prices towards the orders grouped above the #2 point of the Rh. The probabilities of that happening are low."

The probability for a trend to form is lower following a 1-2-3 formation once the #2 point is violated, than it is for a trend to continue after the point of a



Rh is violated.

After the 3rd TTE bar, the probabilities begin to favor a consolidation, which is why we don't attempt to enter with a TTE beyond a violation of the third bar.

After the 3rd TTE bar, the momentum has usually been lost. Be sure to test for additional bars to see if your market and time frame require more.

The market mover knows that momentum is "everything." He will not reach his goal of filling the orders if momentum does not carry him to it.

The TTE offers the possibility of using the momentum of the market mover to cover costs and earn some profits to the trader willing to use it.



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CHAPTER 7

Trading TLOC (The Law of Charts™)

It's now time to put it all together. Since EUR/USD is the most commonly traded currency pair, the charts you see will all be EUR/USD. I have actually traded the charts you will see. I did not choose them to show you winning trades only. You will see the good with the bad. Please realize that I make mistakes, so don't judge me too harshly. In some instances you would have traded the situation differently from the way I traded it. In some instances you would have made far more money than I did. More power to you if you did.

I do not trade in the middle of the U.S. night. My trading is done between 7:30am and 9:00am, U.S. Central Time. I don't believe in sitting in front of a screen trading all day. I want to have a life — time to pursue other things.

In my trading, I break a lot of rules, but they are the generally accepted rules of other people —not my rules. I don't take a lot of trades. I don't trade in and out. I take small amounts on each trade. I don't risk a lot, but I almost always risk more with my stop than the amount I have set for my objective. I don't believe in win/loss ratios. I believe in one thing only — am I making money? If I am, you can have all the statistics you want, have fun with them. But the way I trade, I don't need them.

I don't use indicators for entry or exit. I trade what I see, and in this manual I trade TLOC using TTE and breakouts from consolidation, exclusively. I firmly believe that is all anyone needs to be successful in the markets. I have numerous students who have written to me that the only thing they do is trade Ross hooks using the TTE.

TTE and consolidation breakouts are two implementations of TLOC. I have four other implementations that I use regularly, but they are beyond the scope of this manual. If you want to learn what those are, you can do so in one of my seminars, or in a private tutoring session with me.

We have to begin with the single most important aspect of trading, and that is to assess risk.

There are two kinds of risk. One is the amount of risk with which you are comfortable. No one but you can know what that amount is. There are simply too many variables involved. Some traders are comfortable risking \$100/contract. Others have no problem with \$1,000, or \$5,000, etc. For the examples that follow, I use \$150/contract as the minimum I am willing to risk, and \$210/contract as my maximum personal risk tolerance.

The second kind of risk you must be aware of is the risk in the market. To assess that risk, I use an indicator called "Average True Range (ATR)." There are a number of variations of ATR around, but the one I use is the original study developed by Welles Wilder. It has worked for me for years, and I'm not one to fix what "ain't broke." The number of bars I use for the ATR is 20. The ATR tells me how much money I can expect to get from a move in prices. It also dictates where I place my stop. Furthermore, ATR guides me in choosing the time frame from which I will trade EUR/USD. In summary, ATR is used to:

- Set my stop
- Set my objective (s)
- Dictate my time frame

I set my objective and stop based on the highest ATR of the last 24 hours. I will not trade any time frame over 15 minutes/bar.

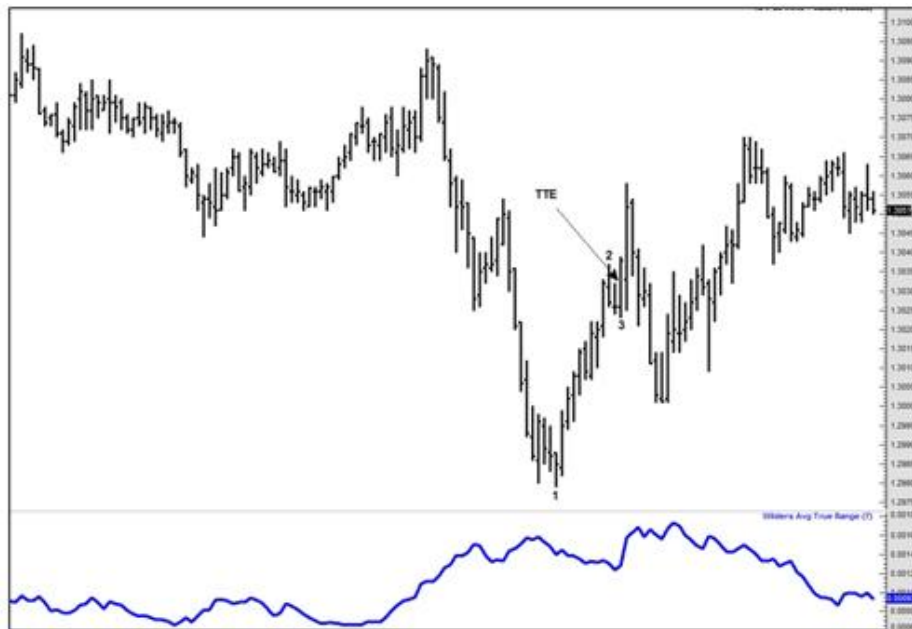
I believe I have to see at least \$150 of risk (volatility) in order to make my minimum objective of \$100/contract on 15 lots. If risk is higher than \$200, my objective will be ½ my risk.

It's July 29. The highest ATR reading from July 28 is .001653. Multiplying .001653 by the size of the EUR/USD contract (\$100,000), I get \$165.30. That amount fits within my risk tolerance. I will risk \$160 on the trade.

I get a 1-2 low in consolidation, and a 1-2 high in consolidation. Prices are moving sideways. No trade!

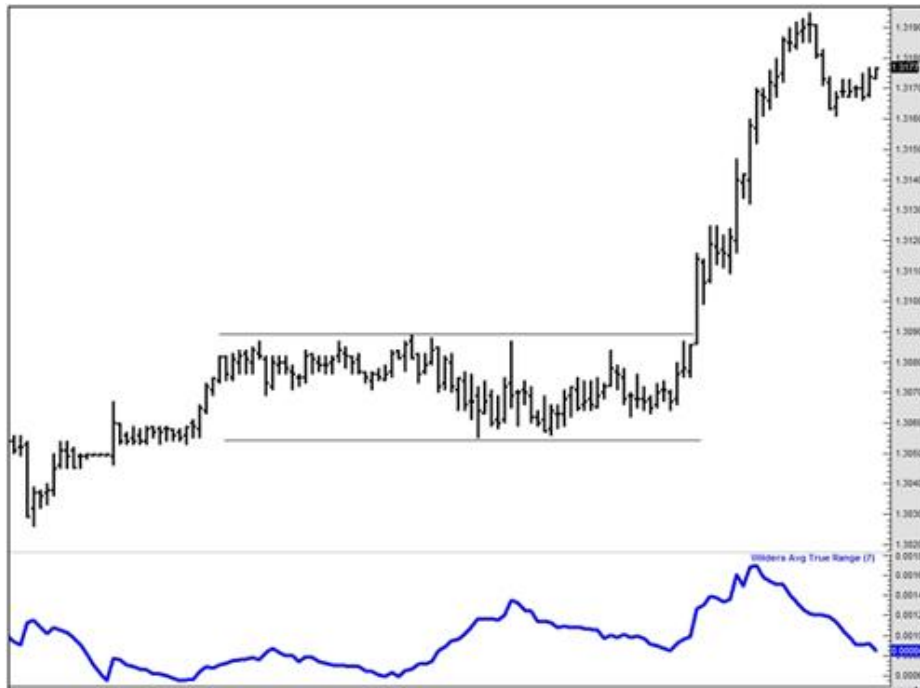


It's July 30. The 10-minute chart of July 29 shows the highest ATR of the last 24 hours to be .001539. Multiplying that number by the size of the EUR/USD contract (\$100,000), I get \$153.90. That amount fits within my risk tolerance. I will risk \$150 on the trade.



Entry is 1.3033. I take some heat at 1.3024 as prices open, fill me, and then backtrack 9 pips. I exit at 1.3042 due to slippage. The trade nets me \$1,350 on ten lots. I also pick up my highest ATR reading, .001732.

It's August 2. The 10-minute chart of July 30 shows the highest ATR of the last 24 hours to be .001732. Multiplying that number by \$100,000 (size of a EUR/USD contract) I get \$173.20. That fits within my risk tolerance. I will risk \$170 on the trade.

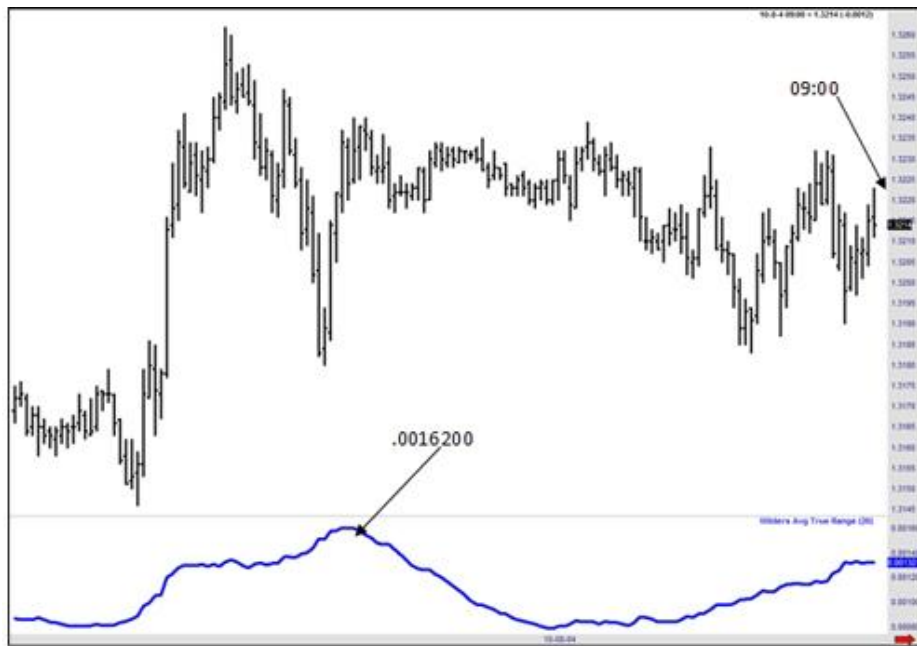


There was a breakout from a trading range on the 10-minute chart. Since I trade breakouts from consolidation, I take the trade, which easily makes me \$1,500. Entry was at 1.3090, on the bar that ended at 07:50. Exit was at 1.3100 a few minutes later. I generally pay 1 pip to trade, and if I would trade more size, I could get that down to ½ pip. Could I have made more on that trade? Absolutely, but I want to leave some money on the table for you!

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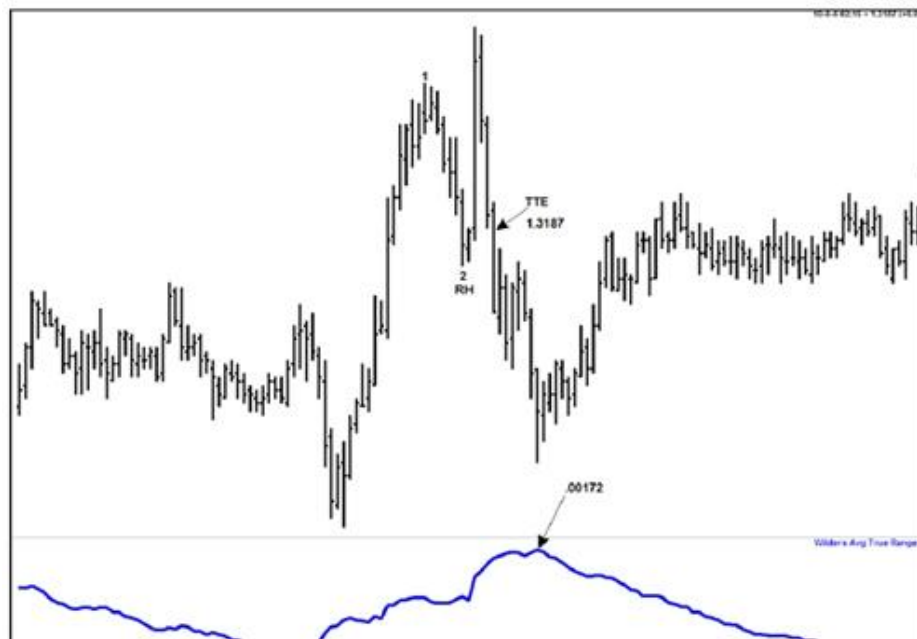
At 10:30am on August 3, the ATR makes its highest reading of the past 24 hours at .001697. If I want to trade on August 4, I have to risk \$170. My objective would be \$100 on 15 lots.

I can't get a trade. No TTE, and no breakout from consolidation by 09:00. Here's the chart.



The highest volatility ATR reading for August 4 was .001620 (\$162.00). Let's see if a trade materializes on the 5th.
 ==

The trade on August 5 deals with one of the finer points of trading TLOC. Let's look at the chart.



Prices made a 1-2 high between 05:45 and 07:15 in the morning. However, the 07:45 bar violated the #1 point, nullifying the potential 1-2-3 high formation. That left the #2 point as a Rh at the end of the leg of a swing. Because I now had a Rh, a tradable TTE developed at 1.3187. Entry with slippage was 1.3185. The trade easily made 10 pips. The most the trade ever went against me was 9 pips, so my 16 pip protective stop was never in

trouble. The highest ATR to use for the next trading day was .00172 (\$170).

==

On August 6 I was faced with a small dilemma. Between 05:30am and 07:30am there was a 1-2-3 low, followed by a Ross hook after a downside breakout from a trading range. However, the TTE did not give sufficient room for me to earn a profit prior to reaching the Rh.

Staying strictly with my rules, I did not attempt the TTE, but in my heart I knew the market movers were gunning for the stops above the trading range.

I opted to wait for a breakout of the trading range. As you can see from the chart, it was the right thing to do.

Entry was at 1.3207 (2 pips slippage). Protective stop loss was at 1.3190. Profits were taken at 1.3220 because of fast market conditions. Every once in awhile you get a break and receive positive slippage.



ATR for the next trading day was .001927 (\$190 risk).

==

Monday, August 9

Prices formed a 1-2-3 low, with a TTE to go long 1 pip above the TTE. As you can see, the trade was a loser. Loss was \$190/contract on 15 lots (ouch).

Should I try again? No. Why? Because studies have shown that if I quit after a losing trade, I'm better off than if I try again.

You will have to do your own study to find out what works best for you.



The ATR for tomorrow is .001927. I will be risking \$190 again.

==

August 10. Prices form a Rh. I have a TTE with 12 pips before reaching the Rh. I take the trade



and make my 10 pips on 15 lots. The ATR, which comes later as the highest of the day, reads .001998.

==

August 11. I have a tough decision to make. There is a Rh with a TTE. However, there are only 10 possible pips between the TTE at 1.2887 and the point of the Rh at 1.2866. If I get any slippage on the entry, which is most likely, I will not have enough room to attempt a TTE. I decide against the trade.



The ATR for the next trading day is .00215 (\$215). That is more than I'm willing to risk per contract on 15 lots.

The solution is to drop down to a 10-minute chart, where volatility is less.

The ATR on the 10-minute chart reads .001860. That is more to my liking. Tomorrow I will trade EUR/USD from the 10-minute chart.

==

August 12. At 07:50am prices begin forming a 1-2-3 low. I check the distance between the TTE and the #2 point. There are only 8 pips available. That's not enough to ensure a winning trade. However, by the time the #3 point is complete, prices are back inside a measuring bar. In fact, if you look at the entire picture you see that from the Measuring Bar onward, only one price bar failed to have either an open, close, or both inside the measuring bar.



The whole mess looks like congestion to me, so I decide to enter on a breakout of the congested area.

Entry was at 1.2833. Exit was at 1.2844 (1 pip positive slippage).

ATR risk for the next trading day will be \$190.

==

I think by now you have a pretty good idea of how I trade, so we will go on to other aspects of your forex trading education.



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CHAPTER 8

Management

At the expense of repeating some things I've written elsewhere, I feel that I need to point out some very basic ideas about management. Quite frankly, I get a bit tired of hearing about money management, money management, and more money management, when there is a whole lot more to management than simply money management.

Whatever happened to such categories as business management, risk management, and trade management, not to mention personal management, without which no other form of management will work?

So, with the exception of personal management which I have written about extensively in Trading Is a Business, let's talk about each of the kinds of management as they relate to forex trading.

Business Management

Business management, when it comes to trading forex, is extremely important. When you decide to be a forex day trader, most traders have erroneously made a decision which in many (not all) cases commits them to spending a lot more time in front of a screen than virtually any other form of trading. Business management, as defined for purposes of this manual, involves all of the decisions you as a trader have to make (should make) involving the physical setup of your trading operation. Questions you must ask are:

- ➔ What will be the physical layout of my trading room?
- ➔ What items will be on my desk?
- ➔ How will I acquire my data?
Which data vendor will I use?

-
- What type and how much data backup will I have?
- How will I maintain and provide back up for various trading essentials?
- How will my trading room be decorated?
- What kind of computer setup do I need?
- What size and how many computer monitors do I want?
- How many telephone lines should I have?
- Do I use some form of ADSL, Cable, T-1, Frame Relay?
- How fast must my data arrive?
- Which particular trading software will I use?
- To which exchanges will I subscribe for data?
- Who will be my broker?
- Which electronic platform should I use?
- What must my furnishings be like in order for me to be comfortable as I stupidly sit in front of a screen for hour upon hour?

This list is by no means exhaustive. There can be more, much more, but I think I've covered the main ones. Let's talk about a few of these items and any additional related concerns that come to mind as we go along.

As you can see from the list above, these have nothing to do with money management; these are business decisions that you, as the head of your trading organization, must make.

Physical Layout

It is essential to your trading that you have the most comfortable physical layout that you can afford. You may be spending a lot of time in front of a screen, especially in the beginning, when you are trying learn what forex trading is all about. Your chair must be comfortable, your desk height adjusted to fit your physique, and any reference materials should be within easy reach. You should consider the color of the room, decorative items, floor coverings, wall hangings, lighting, etc. It must all contribute to your ultimate comfort, and provide a trading environment that is in no way distracting. Anything that will help you focus on what you are doing when you trade should be a major consideration. Anything that might contribute to your distraction or fatigue should be eliminated. Is this common sense? Yes! But how many do it?

Your Desk and Surroundings

I'm not able to tell you what you should have on your desk, but it may be helpful for you to know what I have on mine. First of all, I have a one-line telephone — I receive and make very few calls.

I view the markets from four 17" monitors. I receive my data via super-fast cable — the fastest I can get my hands on.

I keep my trading calendar on my desk for easy reference.

I keep a laptop computer on my desk, always connected to the Internet, fully capable of taking over should something happen to my desktop computer. The laptop is also capable of receiving data through an ultra fast wireless router, in the event I have to take my laptop to your house in the event everything at my house fails to work. I also keep a scanner on my desk, mainly because I use it for writing, among other things.

Last, but not least, I keep a pocket calculator on my desk.

That is all that I have on my desk. All other paraphernalia are elsewhere; in drawers, on tables, shelves, and various pieces of furniture in my trading room. The walls of my trading room are painted in a shade of off-white. The floors are solid pleasant-colored wood. When I look out the window I see grass and trees, very uplifting.

My pointing device (I prefer a trackball) and my keyboard are on trays attached to the underside of the desktop.

Data Vendor

At the time I am writing this, I am using Interactive Brokers for my data. I've been with them for many years. I have had no reason to change.

Software

I am presently using ASPEN GRAPHICS and Genesis Trade Navigator as backups to the data I receive from Interactive Brokers, and Ninja Trader's platform for my trading.

Backup

I back up my data files every day. For me this involves a fairly lengthy process. Being an author and educator as well as a trader, I have need to maintain a great variety of data files, from all the major exchanges, all major markets, and even a few of the lesser markets and exchanges. If I were strictly a forex day trader, barring other compelling reasons, I would maintain only forex data files.

The manner in which I trade forex requires live intraday data. For forex day trading I am not interested in viewing any other time frames than the ones mentioned, except as on a "nice to know" basis.

Broker

Inadequate brokerage is a problem that destroys a great many traders. You really need to do your due diligence in finding the right broker.

Risk Management

What is risk management? My definition may surprise you. It involves more than how much money is at risk. In my opinion, it involves anything and everything you do that either reduces or increases risk.

Here are some considerations:

CONDITION	EFFECT ON RISK
DAY BEFORE A HOLIDAY	RISK INCREASES DUE TO LACK OF PARTICIPANTS AND ILLIQUIDITY.
FAST MARKET	RISK INCREASES. FAST MARKET CONDITIONS CAN RESULT IN BAD FILLS AND SLOW TURNAROUND. YOU ARE NOT SURE YOU WERE FILLED OR AT WHAT PRICE.
TICK SIZE	RISK INCREASES IF TICK SIZE INCREASES. LARGE TICK SIZE IS INDICATIVE OF EITHER A MARKET THAT IS ABOUT TO BECOME FAST, ONE THAT IS ILLIQUID, OR ONE THAT IS BEING MANIPULATED FOR REASONS UNKNOWN TO YOU.
INADEQUATE BROKERAGE	RISK INCREASES BECAUSE YOU ARE UNABLE TO GET THE KIND OF TURNAROUND AND EXECUTION YOU NEED FOR DAYTRADING.
FAILURE TO DOUBLE-CHECK ORDERS.	RISK INCREASES BY INCREASING THE CHANCE YOU WILL FAIL TO NOTICE ORDERS INCORRECTLY ISSUED.
OVERSTAYING YOUR EMOTIONAL OR	RISK INCREASES WHEN YOU STAY IN A TRADE BEYOND

ECONOMIC COMFORT LEVEL	THE POINT WHERE YOU ARE COMFORTABLE WITH IT. YOU RISK IRRATIONAL EMOTIONAL REACTIONS.
OVERTRADING BY: 1. NUMBER OF CONTRACTS 2. TRADING TOO OFTEN	RISK INCREASES WHEN YOU TRADE MORE CONTRACTS THAN YOU CAN EASILY MANAGE. RISK INCREASES WHEN YOU TRADE CONSTANTLY TO THE POINT YOU LOSE YOUR PERSPECTIVE.
VOLATILITY	RISK INCREASES COMMENSURATE WITH INCREASES IN VOLATILITY.
PARTICIPANTS	RISK INCREASES WHEN MARKET MOVERS BEGIN PUSHING THE MARKET THEIR WAY, IF IT'S AGAINST YOUR WAY.
LIQUIDITY	RISK INCREASES WHEN A MARKET BECOMES ILLIQUID FOR ANY REASON. THE S&P TENDS TO BE THE MOST ILLIQUID BETWEEN THE HOURS OF 11:30am - 1:45pm EST
REPORT DAYS AND OTHER SPECIAL DAYS	RISK INCREASES ON REPORT DAYS AND OPTIONS EXPIRATION DAYS DUE TO ABERRANT MARKET BEHAVIOR.

The previous table reflects things that are simply common sense. How many of them do you consider when you are trading? Do you realize that these are not items directly involved with money management? Yet all of them can, in one way or another, increase your risk when you trade.

It is not difficult to see when the market is relatively illiquid; simply look at a 1-minute chart. If it is not well formed, the market is illiquid. There are hours when even the most liquid of forex markets will begin to thin out. That's the time for you to leave them alone. Go do something else.

It is a simple thing to see when a market is fast. Prices will be ticking rapidly regardless of whose software you are using. You can usually also see large tick size when it is happening. Prices will begin to jump, and will no longer be moving 1 one tick at a time. You may see large bars when a report is issued. If you see unusually large bars associated with a report,

you will know a report was not as expected. Don't be surprised if the market movers fade the report. Unless a report brings in massive buying or selling by the public, you can expect the market movers to go opposite to the way you might think they would go as a result of the report.

Use your trading calendar to ascertain when financial reports are due out. Most brokers will furnish you with a trading calendar free of charge. If not, I suggest you [go to the Resources section of our website](#). We can hook you up with the most complete trading calendar you will ever see.

Money Management

Unless you are a scalper, I believe that the minimum number of contracts that you should trade is two. Unless you have at least two contracts, you do not have sufficient flexibility to perform any form of realistic management. With only one contract, the entire outcome of the trade is riding on that single trade entry. With two contracts, once you have cashed your first contract, you can place a stop at breakeven (inclusive of costs) and let the second contract run. That's not my style, but you have to find out what works for you.

Additional contracts

If you are able to trade three lots, the outcome will be much better. With two lots you may be able to make more because you have increased flexibility. Three contracts enable you to quickly cover costs and take a small profit. You can then protect breakeven and a percentage of your unrealized paper profits. With three contracts, you have a much better chance that you will have at least one contract left to let run.

Trade Management

Trade Management was what [Chapter 7](#) was all about. I hope you didn't miss it.

The Essence of Management

The essence of what I've been teaching is that everything must be right.

If you can grasp what I've shown you so far in this manual, you are on your way to becoming successful in day trading the forex.

Let's boil it down right now, so that you are sure of what I've been saying:

- Don't be greedy. Take your money off the table while it is still there to take.
- You can make a fortune if you are willing to nibble the market, taking a little here and maybe a little more there. Occasionally the market will run, and you'll take out quite a bit.
- Your success is guaranteed if you control your losses. How do you do that? By being willing to take a small amount of pips on very high percentage trade setups.
- You will be successful if your wins are greater than your losses. How

do you do that? By looking to see where the orders are accumulated, and then tagging along with the market movers when they run to fill those orders.

- Where do we look for our entry signals? On the chart in the market and time frame that best fits our personal level of risk tolerance.
- Where do we put into effect our trade management? On the chart in the market and time frame that best fits our personal level of risk tolerance.
- Where do we place the initial protective stop? At a level dictated by the ATR, which in turn is telling us market volatility.
- What if volatility is too big for our account or our risk tolerance? Then we look for a smaller time frame to decrease volatility.
- What if volatility is too small for us to trade? Then we move to a larger time frame to increase volatility.
- What if we cannot find suitable volatility? Then we go to another pair, or stand aside.
- Where do we place trailing stops? At no worse than breakeven and one tick above the high (low) of the latest price bar.

Do you have that down pat? If not, then go no further. You are not ready to trade. Go back to the beginning, and read everything again. If you think you have everything set in your mind then...

Let's keep looking. Let's move on to [Chapter 9](#).



Day Trading Forex

by Joe Ross



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CHAPTER 9

Odds and Ends

The reason 1-2-3s in consolidation are not setups for using the TTE formation is that consolidation areas have 1-2-3s in both directions.

Usually there is simply not enough room to make a decent profit. In the chart below, note the #1 points marked in red are also Ross hooks.



What is needed is a tie-breaker. The tie-breaker will not only increase the likelihood of a successful trade, but will also be a strong indicator of the direction the breakout will most probably take. That tie-breaker is the Ross hook.

When a market is moving sideways, the trader must see a 1-2-3 formation, followed by a Ross hook, all occurring within the sideways price action. The entry is then best attempted by using the Traders Trick ahead of a breakout of the point of the Ross hook.

Of course, nothing works every time. There will be false breakouts.

However, on a statistical basis, a violation of a Ross hook occurring when price action is sideways consistently results in a low risk entry with a heightened probability for success. Since the violation of a Ross hook occurring in a sideways market is an acceptable trade, then an entry based upon a Traders Trick ahead of the point of the Ross hook being violated offers an even better entry.

Let's look at that now.

The situation on this chart shows why it is important to have enough room between the TTE point of entry and a Ross hook. You might notice that it is similar to the last trade made in the previous chapter.

It also shows why we cannot use 1-2-3 formations as setups for 1-2-3 low.

There are two Rhos labeled on the chart (↓ ↓). But the TTE (↗ ↗) for each one did not have sufficient room for a scalping profit. Because of that, I chose to enter (↘) on a violation (breakout) of the trading range. Prices shot straight up, giving me 107 pips by the time I got out.



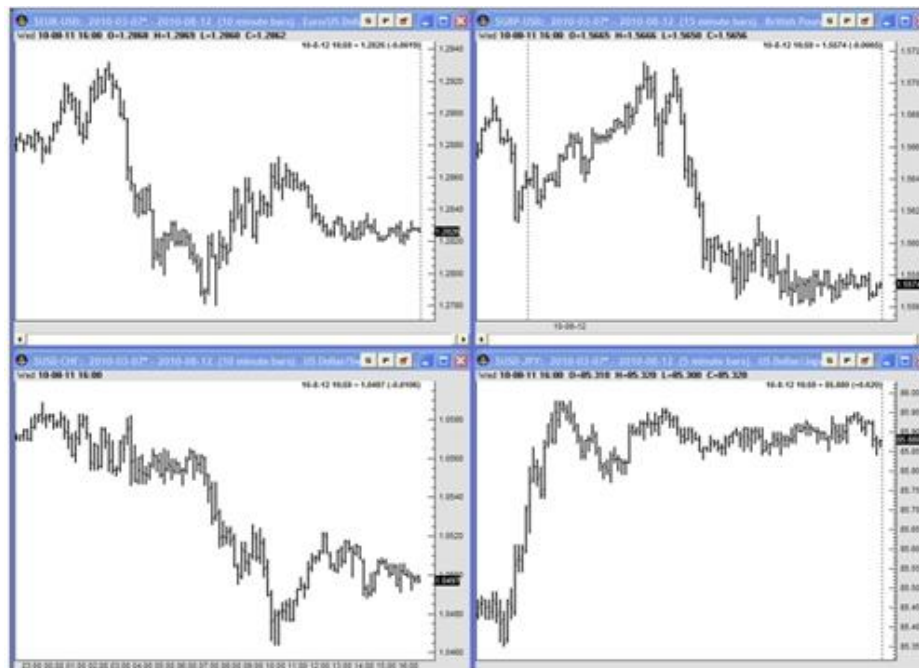
I've been showing you EUR/USD on intraday charts. The question that comes up is "What do I do on days when there is no trade?" My answer is that on those days, I don't trade. However, I almost always find a trade in another currency pair.

I like to trade the majors because of liquidity. So I usually have four charts on my computer screen: EUR/USD; USD/JPY; GBP/USD; and USD/CHF. I use these strictly for day trading. If you want to trade longer term, there is much more money to be made in trading the cross rates.

I look to see which chart is setting up the best. I can then choose which of the four suits me best.

It is possible that all four charts may be trading in different time frames. The time frame I use is dependent upon my personal risk tolerance.

I get very frustrated when people tell me they want to trade a particular pair exclusively, and always in the same time frame. Why would someone limit his choices and flexibility in trading in a field where political and economic situations can change the potential profits, and why always in the same time frame?! It simply doesn't make any sense.



You must fit the market and the time frame to where you feel comfortable trading.

Some will ask, "Why only 10 pips and then out?" The answer is that it is a lot easier to get 10 pips then it is to get 20, or 30, or 100.

If I can earn 10 pips on 15 lots 80-85% of the time, why not trade for 10 pips? Do the math.

If I risk 20 pips to make 10 pips and win 8 out of 10 trades, there is no way I'm going to lose.

10 pips x 15 lots gives me \$1,500. Eight times \$1,500 gives me \$12,000. If I take two maximum \$3,000 hits, I will lose \$6,000. I am still ahead \$6,000.

However, in my actual trading I win 85% of my trades. That means I win \$12,750 and lose \$4,500. I am ahead even more.

I learned a long time ago that the less I trade, the more money I make. That has proven true not only for me, but for hundreds of other traders who have learned that lesson.

People will ask me if they can use these techniques to trade other markets. The answer is "yes." You can trade not only other markets, but other time frames as well. The only thing that you cannot do is use the ATR on charts greater than 15 minutes. For other markets, other time frames, or both,

you need to find some other technique for protective stop placement and objectives.

If you try to use ATR for trading daily forex charts, you will find that you are taking huge amounts of risk. I have a technique for stop and objective placement in larger time frames, but that information is beyond the scope of this manual. You can learn about them at my seminars and in private tutoring.

Another question sometimes arises: "What if the 15-minute chart has too much risk via the ATR reading, and the 10-minute chart has too little?" The answer is to step down to the 14-, 13-, 12- or 11-minute chart to find acceptable risk.

"What if the 2-minute chart has too much risk and the 1-minute chart has too little? Then what do I do?" The answer is to look for a different market to trade, or take the day off and relax. You don't have to trade every day, and you certainly don't have to trade all the time. There's a time for trading, and a time for other parts of your life.

Preparation

There are several things I do to prepare for a trading session. The first one is the easiest: get a good night's rest. For me that consists of 4-5 hours of sleep. The second is almost as easy: eat a solid breakfast. I may have a long day ahead of me in the rare event that I choose to trade more than my allotted 1.5 hours/day. Trading for longer than 1.5 hours is such a rare event that I can't recall the last time I did it.

Being a morning person, I prefer to trade in the morning. Typically, my trading day begins at 07:30 and ends at 09:00.

Once I am awake, the first thing I do is to take a good one-hour exercise workout. I try to include some form of aerobic exercise to get me breathing deeply before I end my workout.

Then, after a quick shower, I eat breakfast, and I'm ready to begin dealing with the market.

The first thing I look at is the value of the ATR from the last 24 hours. ATR has to fit within my comfort zone.

I then look at the four major currency charts in a time frame that coordinates the amount of risk in the market with the amount of risk I am willing to take.

Important Step

It is important to take certain steps prior to trading. I feel it is important to make note of the pointy places above and below where the market is at 07:30. I know that is where the orders will be grouped together, and since it is the job of the market to fill those orders, looking gives me some idea of which way the market movers will take prices. I believe it is important to determine whether or not the market is moving sideways or is trending on the chart for the market and time frame I will trade.

Report Days – Be sure to check out the times of these reports

The reports that most affect the U.S dollar are reports of a financial nature. These include, but are not limited to:

- The Employment Condition [monthly]
- The Producer Price Index [monthly]
- The Consumer Price Index [monthly]
- Business Inventories [monthly]
- Capacity Utilization [monthly]
- Housing Starts [monthly]
- Labor Costs [quarterly]
- Consumer Confidence [monthly – during the open outcry session]
- NAPM Manufacturing and Non-Manufacturing [monthly – during the open outcry session]

When the markets are extremely sensitive, almost any economic report will cause them to react and move substantially. Generally, for traders of the major currency pairs it is important to know that most of the reports affecting the U.S. dollar are issued at 07:30am, U.S. Central Time. If the report is of consequence to the U.S. dollar, it will register as a large outside bar visible on a chart showing the pair trading that takes place between 07:30 and 08:15. If the report comes out later, say 09:00 or 10:00, it has the potential of making prices jump, and temporarily making the market fast.

The large outside bar is caused by traders holding various positions trying to "square-up," get flat, or reposition themselves relative to the information in the report.

Report results must be assessed

For electronically traded currencies, both forex and futures, the report has to be assessed while the market is trading. What you will see is an initial reaction to the content of the report. However, the report usually has headlines that are misleading. It takes anywhere from a few minutes to more than an hour for reports to be fully evaluated. The initial reaction to the report may be based on an entirely erroneous view of the actual market situation. Here is an example of what I mean:

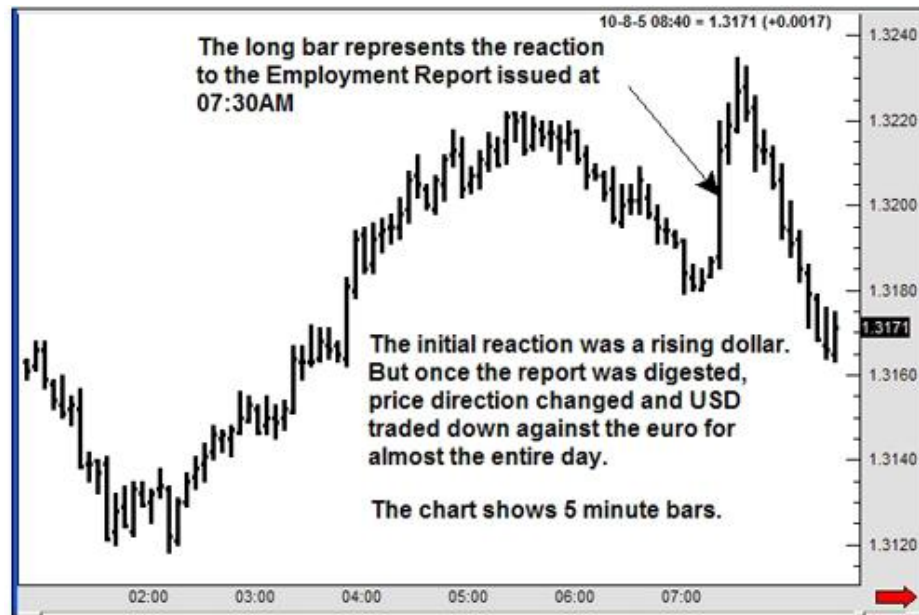
The Employment Report in the U.S. is almost always misleading. Even the name of the report is misleading. The report should be called the "Unemployment Report," because that is what is important to the way the market will react to the report. No one really cares about employment when there is a situation of "full" employment. The worrisome thing is always the number of unemployed.

When the report is issued, the headline might read, "100,000 new jobs!" That sounds good, and so the dollar will jump up against the other currencies. But as the report is read, it is discovered that the 100,000 new jobs are only temporary. Perhaps they reflect the hiring of Census takers, who will work for only the next 3 months. The new job might be temporary workers hired to clean up a major oil spill. In fact, in 2010 both of those

kinds of temporary jobs were created.

As the report is read even further down, it is discovered that due to the oil spill, 300,000 workers are out of jobs, and even more are expected. These are permanent jobs, and this is very bad for the U.S. dollar.

All of sudden the U.S. dollar, which only a few minutes before was rising like a rocket, is now found to be falling like a huge rock. What has happened is more or less what can happen with any of the reports issued by government. Government reports coming out of Europe and Japan have similar effects on currency pairs.



What should you do about reports?

My best advice is to stand aside. Stay out of the market until after the market settles down and finds its balance subsequent to the report. This may take as much as half an hour. Learn to be patient.

Although studies have been made relative to the way the market breaks after a report is issued, I have never found any action to take that is better than standing aside. In my opinion, trading off "report bars" under any conditions is a poor way to trade.

Other studies, and indeed entire manuals, have devoted themselves to the reliability of trading the breakout of a report bar. In my opinion, this has not been proven to be a good way to trade. Perhaps it is a good method for market movers. But I am not a market mover.

I make it a habit to trade the currencies during the times that most U.S. traders are in the markets. However, if you live in Europe or Asia, there are other excellent times. Volume and liquidity are very good when the Asian traders enter the markets. They are good again when the European trader enter the markets. In general, there are three good times during 24-hour periods when it is best to trade forex. Those times are when traders begin trading in Tokyo, London, and New York.

An essential understanding

What I say next is of the utmost importance in your understanding of how to trade any market. It is the purpose of the market movers, and where applicable, the locals and the floor brokers, to fill orders. Although no one trading on the floor or on an electronic platform is required to make a market, the market movers have much to gain by acting in the capacity of market makers. In the absence of a large order flow from outside the market, prices will always go where the preponderance of orders are located. In the situation of the Employment Report, the only way prices could have continued to go up would be under conditions of massive dollar buying by the public, or a rather large manipulative trade by a market mover hoping to take the market even higher in order to be able to sell at a higher price. In other words, a flood of buy orders coming in from the outside, or a purposefully manipulative move by someone in a position to move the market, are the only likely situations that could cause the market to continue up much further after the report was fully digested. Such a situation is rare, and if it occurred, you would in no way be hurt, because you would not be looking to buy this market using the concepts behind the method I teach you in this manual. In the absence of such massive buying, the market is going to move down because most orders in the market after the report are below the market, in the form of sell orders.

Where the orders are located should always be one of your first considerations in trading. Where the orders are must be your primary filter in every trading situation you will ever encounter. If you can figure out where the orders are, you can safely and profitably trade. If you are not sure where the orders are, you should not consider entering a trade.



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CHAPTER 10

If you need a filter

Traders invariably ask me, "but how do you filter 1-2-3s and Ross hooks?"

The answer is, "I don't!"

However, I realize that many traders have been brain-washed into thinking that they need some kind of an indicator to agree with what they should be able to plainly see by looking at the chart that is staring them in face. So, for those of you who absolutely must have an indicator, I will present you with one that is quite effective for those who can't live without one.

Stochastics

When you see how it is really done, I think you will be pleasantly surprised. I include it in this book because it works so well as a filter for the 1-2-3 and Ross hooks via the Traders Trick Entry. Everything I show will be Stochastics together with Ross hooks, but you can apply the filter equally as well with 1-2-3 formations.

Stochastics is so widely used as an indicator that you should be able to find it in all trading software. I cannot imagine a charting program that would not have Stochastics included as an indicator.

The method is based upon an observation: as price increases, daily closes tend to accumulate closer to the highs of the daily range. The opposite is also true: as price decreases, daily closes tend to accumulate closer to the lows of the daily range. This observation is derived from intraday monitoring of closes, but works in any time frame.

There are two valid signals available when working with the Study and the Ross hook. Buy and sell signals are based entirely on a crossing of the "D" plot by the "K" plot.

Divergence indicates that a hook should not be taken because the trend may be ready to end.

For example, when prices have made a new high, then react, and subsequently move to a higher high, while corresponding peaks of "D" make a high and then a lower high, a bearish divergence has taken place. The ascending trend may be almost over.

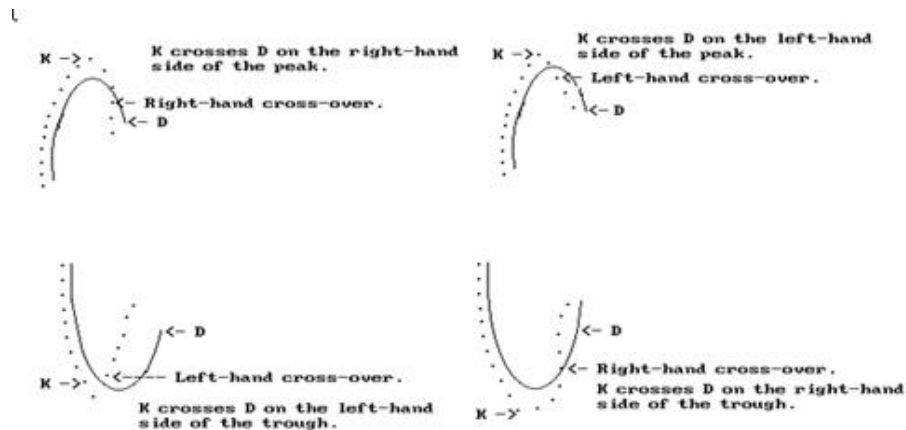
If prices have made a new low, then react, and subsequently move to a lower low, while corresponding troughs of "D" make a low and then a higher low, a bullish divergence has taken place. The descending trend may be almost over.

Here is a very important refinement: the original signal was to act upon the divergence when the "K" plot line crossed on the right hand side of the peak of the "D" plot line at a top, or on the right hand side of the trough of the "D" line at a bottom.

This concept still works, and is especially true when a market is in congestion and about to break out.

When trading Ross hooks, all we care about is the fact that the "K" plot line has crossed the "D" plot line. It makes no difference in filtering the hook entry as to which side the crossover takes place. We do care at which level the crossover takes place. We don't want a crossover above 75 for an up move or below 25 for a down move, but we most certainly don't care about any such foolishness as "overbought" or "oversold."

Let's look at the crossover concept so you'll know what I mean by crossover. This is "nice to know" information, not something to use.



Let's look at how this would work with EUR/USD. We will use a 5-3-3 Stochastic with overbought set at 75 and oversold set at 25. The blue line shows %K (fast Stochastics), and the red line shows %D, (slow Stochastics).

Prior to trading with the Stochastics, we will have done everything we learned earlier: assessed our personal risk tolerance; assessed the risk in the market; decided which market and time frame we are going to use based on ATR; determined our trading style – scalp or try to run with the

market; determined how many contracts to trade; determined where to place our protective stop; and determined our objective (s).

As we view the 10-minute chart from left to right, we see that we are looking at a TTE which could have been the result of a 1-2-3 low or a Ross hook. Since this is the earliest data on the chart, it really doesn't matter. What matters most is, "should we attempt to enter one tick above the fourth bar of correction?"

The vertical cursor indicates that if the high of the fourth correcting bar is violated, %K will cross %D. We then place a buy order 1 tick above the high of the fourth correcting bar. You can use buy limit or buy stop market. It's up to you.

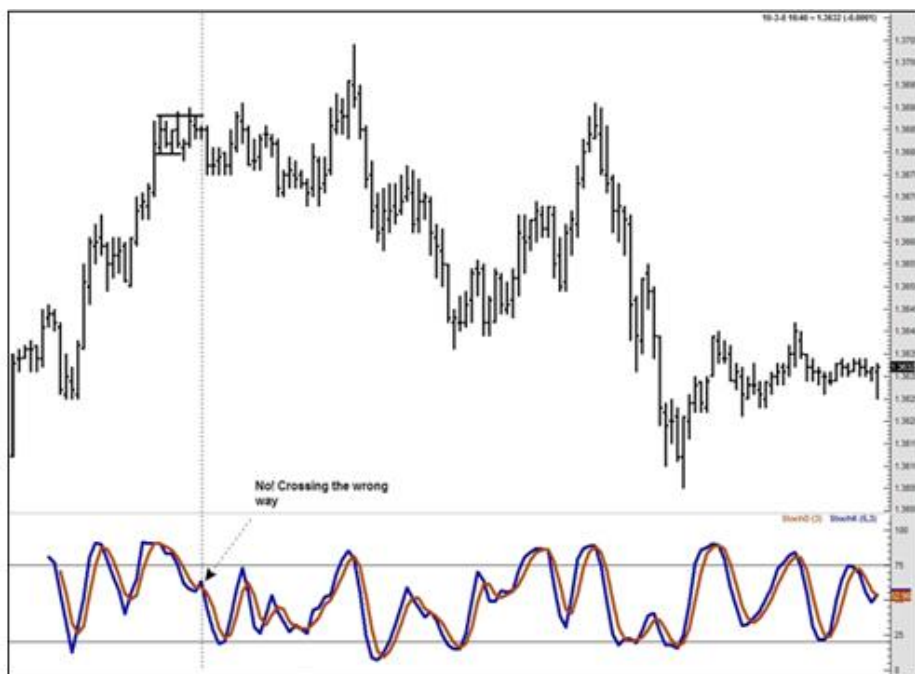


Using the same chart, let's look at the Ross hook that follows the trade we just made.



%K gives the signal saying it's okay to buy a breakout of the cluster. If the top of the cluster is violated, %K will cross %D.

The next available trade is a ledge. Should we attempt a breakout of the ledge to the upside?

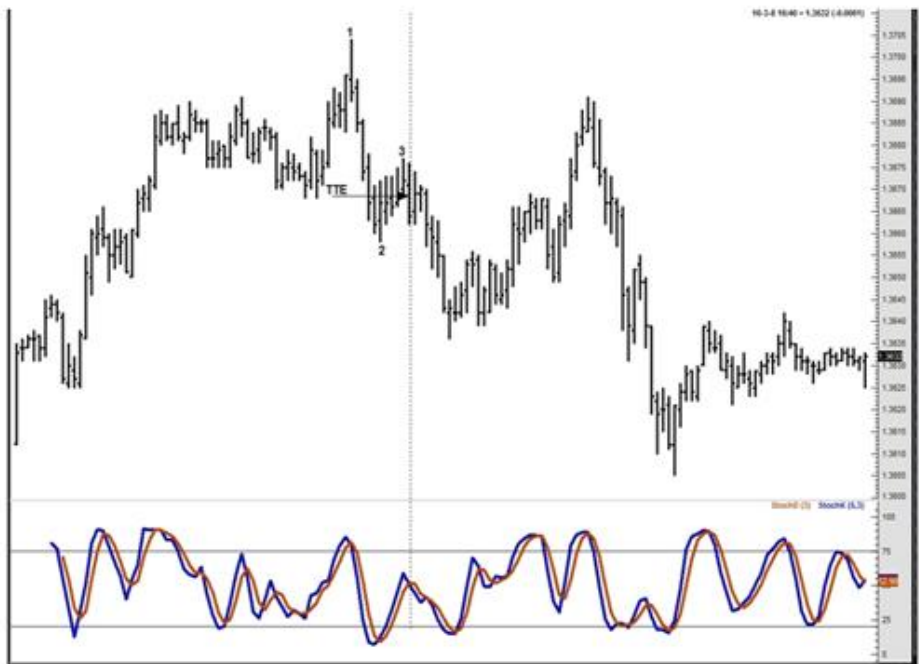


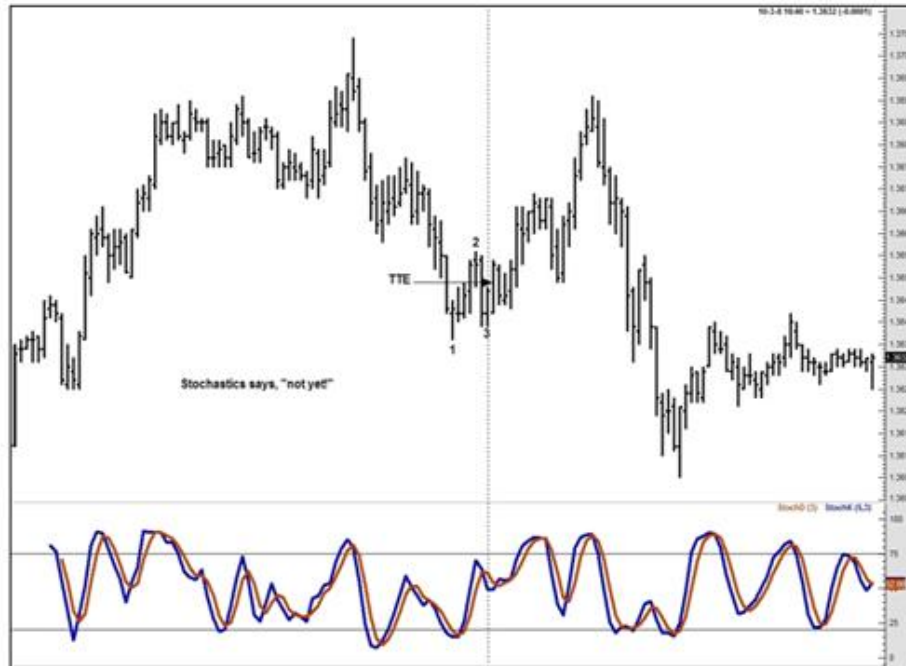
Stochastics negates the trade, it says "NO!"

We now have a trading range. Should we take a breakout to the upside? No! %K has already crossed %D.



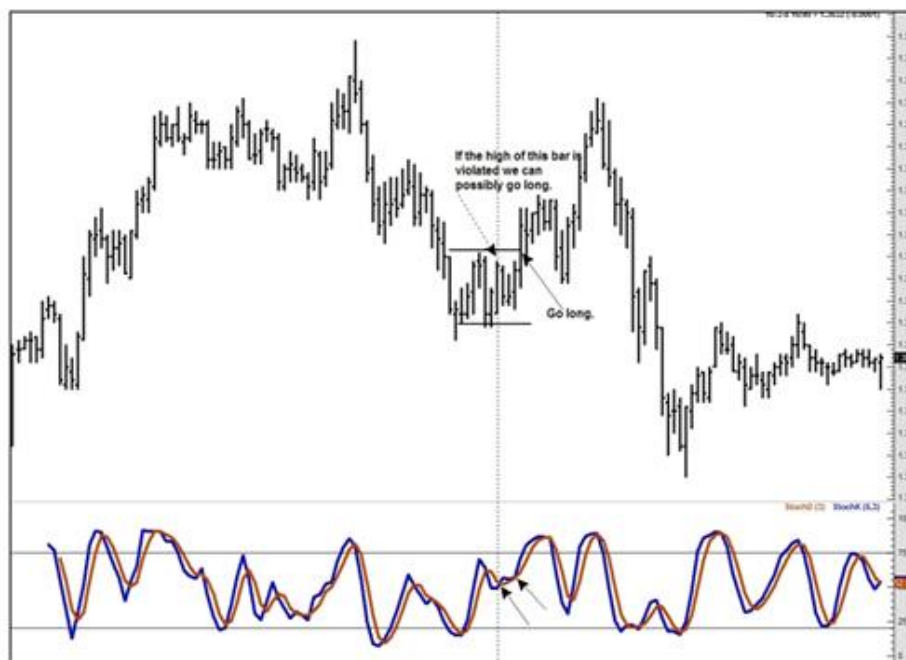
We have a 1-2-3 high. Should we go short? Stochastics says yes! %K will cross %D.





It's not clear that %K will cross %D. Stochastics says, "not yet," we have to wait. However, Stochastics indicates that if the high of the next bar is violated, %K will pass through %D.

Next we have a ledge, but because the prior trend was down we can take only a breakout to the downside. However, since the ledge involves a 1-2-3 low as well as a cluster, we can take a breakout of the cluster to the upside, especially in light of the possible Stochastic signal. In other words, when all the evidence is put together, we have a strong signal to go long.



Trading with an indicator is not an exact science. Some judgment must be

made as to whether or not a violation of a TTE or consolidation will result in %K crossing %D.

The next trade is a TTE. However, Stochastics does not give a clear signal. %K is not about to cross %D. In fact, at the time we would look at it, it is still moving up. Using indicators does not always pay off, nor does not using them. If we are using Stochastics to filter the trade, we miss this trade.





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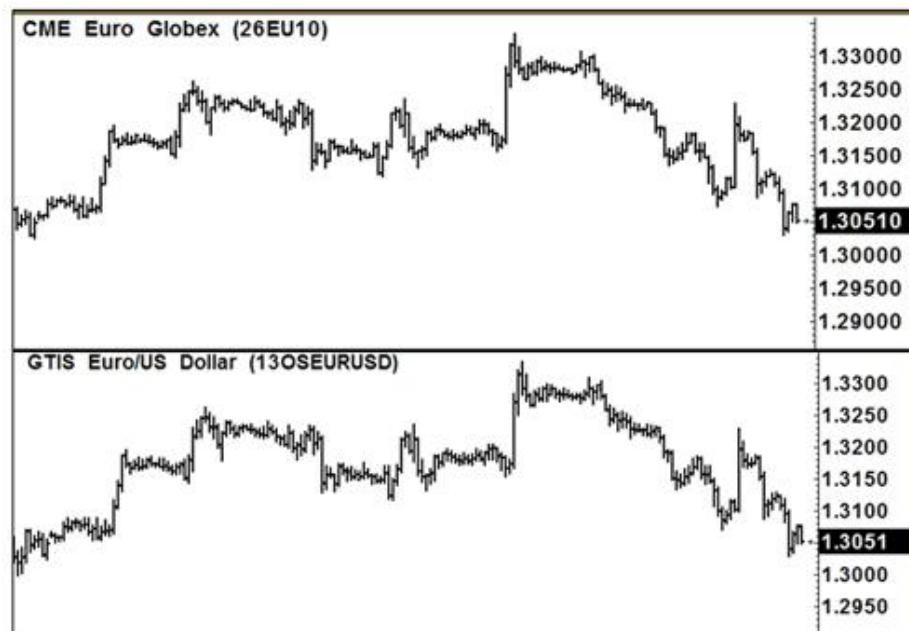
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Appendix

Deciding between forex and futures

If you're new to currency trading and have begun trading forex as a result of the marketing hype and hoopla surrounding forex trading, then you may be in for a shock when I tell you that for trading any of the majors against the dollar, you are often a lot better off in the futures markets than in the forex markets. Let's see why that is.



We begin with a chart I posted earlier in this manual.

As you can clearly see, there is virtually no difference between the futures chart and the forex chart.

So why trade futures? I can best tell you by doing an item by item comparison between forex and futures. Bear with me! For many of you, what I have to say can be rather startling. However, don't despair and think that you've wasted your time. What works in forex often works even better in futures.

Money Movement

When trading the U.S. dollar against any of the majors, each 1 tick move is valued at \$12.50, except for the British pound, which ticks at \$6.25. However, the pound in the futures market seems to always tick two ticks at-a-time, so a move in the pound is valued at \$12.50.

A forex pair never moves above \$10/pip, and the pip values are not precise. Why does that matter?



It's 2:00pm, August 13, and we are looking at the euro FX traded on Globex at the CME in Chicago (top) chart, and EUR/USD traded at FXCM, ostensibly the largest forex broker in the U.S., maybe the largest in the world (bottom chart). Both charts display 60-minute bars, and amazingly you can see and read the volume on both charts. Very few forex brokers are willing to show you volume. Why that is will soon become clear.

The high of the bar that began at 2:00pm in futures reads 1.29060. The low of that bar reads 1.28610. The difference from high to low is .0045, or 45 ticks at \$12.50/tick = \$562.50.

The high of the bar that began at 2:00pm in forex reads 1.29048. The low of that bar reads 1.28610, or 43.8 pips x \$10 = \$438.

In this case, futures moved more ticks at \$12.50, than forex moved pips at \$10.00. Typically, futures and forex move approximately the same. But it

should be clear that it is much easier to make \$100 in futures than it is to make \$100 in forex. For forex to match futures as far as movement is concerned, forex has to move 20% more than futures. I have never seen such a move, and don't believe I will ever see one.

Just so you can get a feel for what I'm talking about, let's say that forex had moved 45 pips and futures had moved only 42 ticks. Forex would have moved \$450, but futures still would have moved more at \$525.00. Even if futures moved only 40 ticks, it still would beat forex hands down.

In a market move, where both forex and futures move approximately the same, I can make \$100 with only 8 ticks in the euro futures, whereas in forex I have to have 10 pips. It should be clear to anyone that it is easier to make 8 ticks than it is to make 10 pips.

Convenience

There are no conversions needed in futures. Everything is denominated in U.S. dollars. Dollar-wise, you always know where you stand. There are no debits and no credits vis-à-vis short and long. This is not true of forex, where you are never quite sure just how much money you have in your account.

Commissions vs. Spreads

In futures there is a commission to pay. Forex brokers make a lot of noise about this, claiming that with them there is no commission. However, you have to be quite naïve if you think that you don't pay to trade forex.

I pay \$4.80/round turn to trade futures. There are many who pay even less than that. When I trade forex, I pay 1 pip — \$10/round turn to trade the majors. That's more than twice as much as I pay to trade futures. For some of the minor currencies the spread can be 2-5 pips. Now you're going to tell me that \$10 is no big deal. Let's look at it another way. Let's pretend that you own a shoe store and you sell shoes for \$20/pair—all shoes all sizes. What would happen to your business if I opened up across the street from you and sold the same shoes, all sizes, for \$10/pair? Need I explain further?

Safety

If your forex broker absconds with your money, or goes bankrupt, or goes out of business, what recourse do you have? None!

If a futures broker goes bankrupt or goes out of business, you will never lose any money, and there is no way the broker can abscond with your money, ever! Why is that?

Futures brokers are required to maintain accounts with clearing firms. Once every 24 hours, every broker must show that he has cash on hand or equivalents (government bonds, notes, and CDs) sufficient to cover every open position. The broker is not allowed to hold your money in any of his accounts. The money must be held in a separate account with the clearing firm in such a way that it cannot be comingled with the broker's money.

The clearing firm, in turn, must keep the money at a bank in an account that is totally separate from the bank's money. This whole process is called "marking to market." It insures that, if your broker, the clearing firm, or the bank goes out of business, your money is still there.

Are you aware that no one has ever lost any money in a futures trading account by virtue of a broker going broke? When Refco, the biggest all-futures clearing firm had to shut down due to its CEO making illegal money transfers, not one cent of futures traders money was lost. Futures accounts were immediately transferred to another broker with all positions intact. But what happened to Refco's forex traders? At the time I'm writing this, they are still waiting for their money. They will be fortunate to get back 10 cents on the dollar. In fact, by time they get their money back, the dollar may be worth only 10 cents.

Hours

It seems as though forex has futures beat when it comes to trading hours. Forex trades around the clock, 24 hours each day, with only a few hours during which no trading takes place on the weekend.

Futures trade 22 or 23 hours/day, with similar time off on weekends as you find in forex. What in the world are futures exchanges doing during those hours when forex is trading and futures are not? Why, they are marking to market, of all things! They are making sure that your money is safe. Isn't that terrible? You'll just have to kill time — have a sandwich and a beer, and cool your heels while the futures markets are marking to market. Do you know anyone who trades 24 hours/day?

Free data

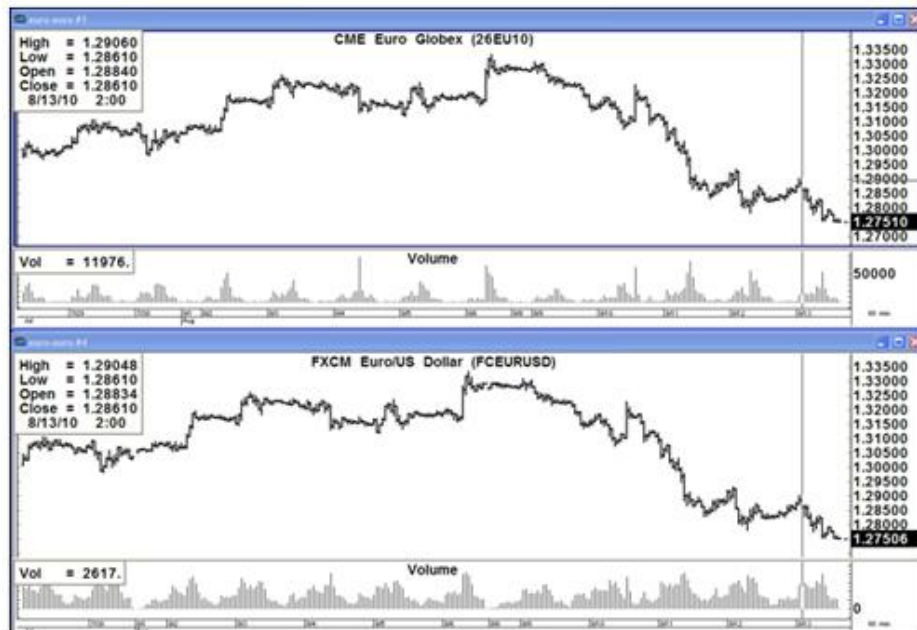
Now, there's a real big deal. At least it would seem so. It's pretty hard to beat free data. When you trade futures, you have to pay for data, and it isn't cheap. You pay anywhere from \$60-\$90/month depending on which exchanges you use. However, if I trade futures at Interactive Brokers, I pay nothing for data. I pay only if I make no trades — \$10/month.

Is the data really free at a forex broker? With some it is, but with others they have a way to cheat you. It's called "leaning." What the broker does is skew the data feed. This is really easy to do when a trader opens a mini account. The banks trade full-size contracts. But when you trade mini accounts, those full-size contracts have to be broken down. At that point, the broker can show you whatever price pleases him. There are many forex brokers who cheat. I was asked to teach at one in the State of Florida. That broker was leaning the data feed by 7 pips. On top of that, he was charging 3 pips to trade. That was 10 pips in all. He was scamming traders for \$100/round turn and they never even knew it. How can that be? When people traded at that brokerage, it was the broker who was taking the other side of their trade. That's called a "bucket shop," in case you didn't know.

Volume

It is said that volume in forex far surpasses that of futures. I would have to agree that this is so, over all.

But is it true where you do your trading? Let's do some figuring.



The greatest volume of trading is done in the EUR/USD pair. \$800 billion/day.

Forex Peace Army lists 372 forex brokers — not a complete list, but let's use that number.

800 billion divide by 372 = two billion, one hundred fifty million, five hundred thirty-seven thousand, six hundred thirty four. (2,150,537,634). So there is a little over \$2 billion available for trading at each brokerage or bank. Of course, not all brokers have the same volume of money traded.

Moreover, if you trade anything other than full-size contracts, you have no idea of what the prices are among the banks and dealers. For the most part, you will be trading against the other small traders who have opened accounts with your broker, or trading against the house. Be aware that some forex brokers have very few actual customers. Unless there are thousands of other traders trading your favorite currency pair at your chosen brokerage, liquidity will be very poor. You can see that in the chart above. Despite the huge volume in forex, the volume at any given forex broker can be far less than the volume traded in the futures market. On August 13, 2010, volume for a 60-minute period was 11,976 contracts traded vs. 2,617 traded at FXCM, considered to be one of the biggest brokers.

What if the biggest forex broker did 15 times the volume of any other broker, would it be improper to assign \$30 billion/day in volume to that broker? How does that compare with the volume in futures? Average volume for the euro at the CME is \$37,500,000,000—thirty-seven billion, five hundred million/day, but all of that money is traded in one place, on a single regulated exchange, which brings me to the next point.

Transparency

At the futures market, everyone sees the same price at essentially the same time. Prices are completely transparent. However, with a forex broker, not everyone sees the same price at the same time. For example, Interactive Brokers lists 12 different dealers for filling forex trades. In other words, the broker will search out the best available price for giving you a fill. Best available price means that not all dealers have the same price. In fact, at any given time EUR/USD can be trading at dozens of different prices at dozens of different banks and dealers.

Note: I have mentioned Interactive brokers (IB) several times in this manual. However, please do not take the fact that I use them for trading as a recommendation for you to use that broker, especially if you have a small account. Mini accounts at IB require considerably more money than with other brokers.

Conclusion

If you are going to trade the cross rates, you must trade them in forex; volume liquidity in the minor currencies are not good in the futures markets.

If you are going to trade any of the majors against the U.S. dollar, then it's safer, more regulated, and more transparent to trade in futures. By majors I mean pound, franc, euro, and yen, along with Canadian, Australian, and New Zealand dollars. Other currencies could at any time become major. Certainly, the Chinese Yuan will become a major if it is ever allowed to float. The Brazilian real and the Indian Rupee may also be headed for status as a major.

If you have limited funds, you are better off with a mini account with a forex broker than you would be with a mini forex account trading at the CME.

If you want to get some of the best moves, the most bang for the buck, try the cross rates. They move a lot more than do the majors, but don't try to day trade them; the spreads are too wide for you to make any money.

I wish you all the best in your trading,



Joe Ross
Trader, Author, Trading Educator