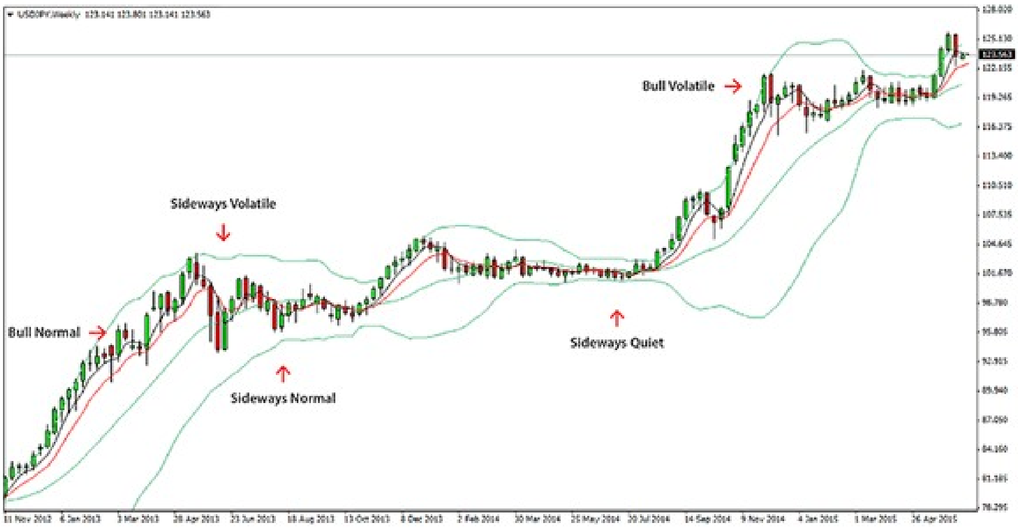


The First Rule of Forex Trading: FX Market Types

www.actionforex.com
4 mins read

Have you ever found that your trading system works great one day but fails miserably the next?

Your problem is quite possibly market type identification.

Too many Forex traders will trade the same way no matter what the market is doing. Instead look to identify the market type first, and then devise a strategy appropriate to that market type.

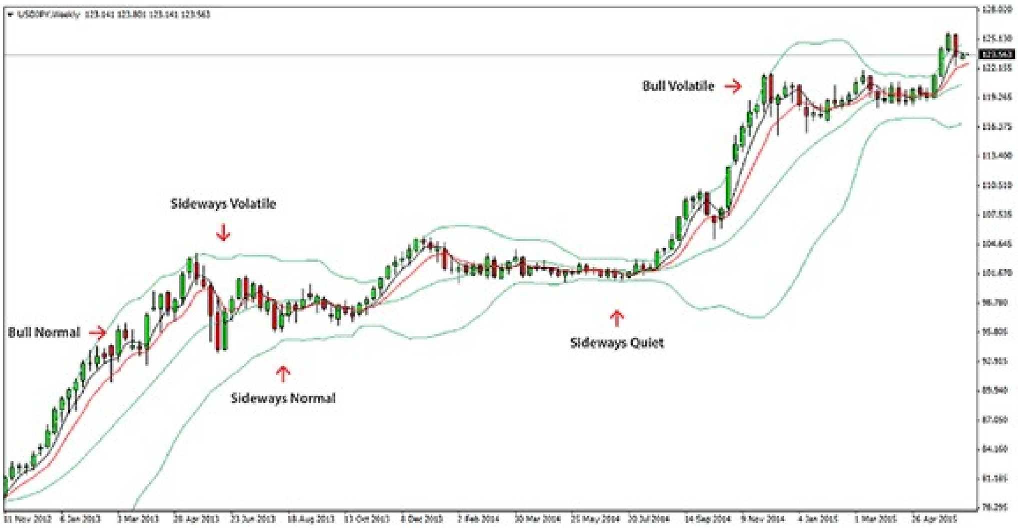
Sounds simple?

With the right technique and a little practice you will find you that you will be able to quickly tell what market type you are in and how to trade it.

There are six primary market types in Forex that you need to be able to identify:

- Bull Normal
- Bull Volatile
- Bear Normal
- Bear Volatile
- Sideways Quiet
- Sideways Normal

You can see the different market types here quite clearly on this weekly chart of the USDJPY.



Each of these FX market types requires a different approach from the trader.

If the market type is quiet wait for a breakout or range trade, if the market type is bullish then look to buy dips, if it’s bearish look to sell rallies.

When market types change

Like the weather, market types shift and change. The good news is they do so in a predicable manner.

Volatile market types settle into normal then quiet markets. Bull markets turn sideways before they turn bear, and quiet markets expand into trending bull or bear markets.

As a trader you want to be aware of what market typically comes next and plan accordingly.

How to identify the market type

While there are numerous ways to identify market types, here is an intuitive model you can follow visually by looking at the charts.

For this we use two sets of indicators:

- Bollinger bands
- A 7 period and a 3 period Exponential Moving Average (EMA)

These can be applied across any time-frame on any chart to provide you with an easy to use method of identifying the current market type.

Bull normal market types

A bull normal market type can be identified by the price trading above the Bollinger band while the 3 period moving average is trading above the 7 period.

Here is a great example on the daily chart of the GBPJPY:

The strategy

In a bull normal market type there are generally two strategies that will be effective.

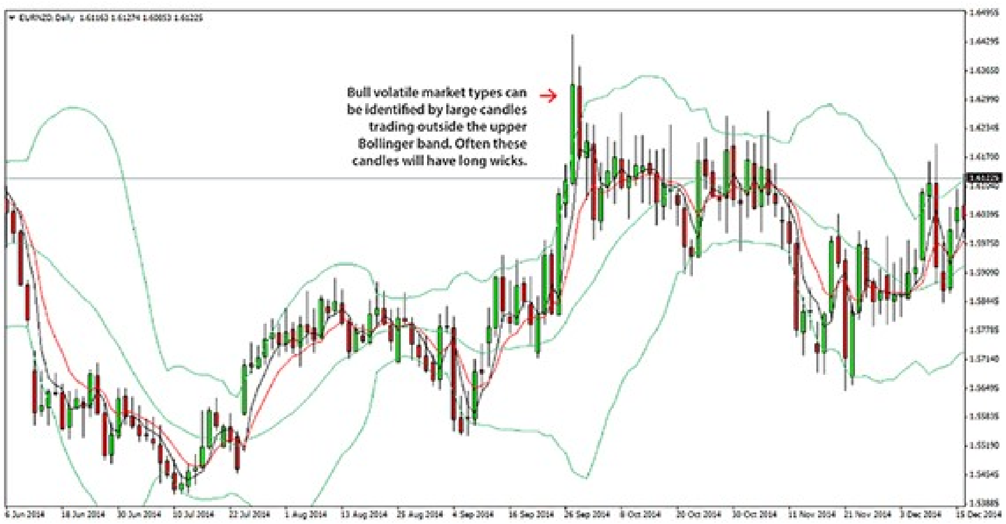
1. Buying dips. You set limit orders at key levels or wait for a pull-back and indication that the trend is going to continue.

2. Buying breakouts. You wait for periods of consolidation and then buy breakouts in the direction of the trend.

Bull Volatile market types

Bull volatile market types can be identified by large candles trading above the Bollinger bands. Often these candles will have long wicks.

You can see this market type here on the daily chart of the EURNZD.



The Strategy

In volatile bull market types, it can be tempting to rush in and buy, but his may not always best the best course of action as prices can quickly reverse. If you are lucky enough to be in a position that turns into a volatile bull then keep your stops tight.

You can see here on the 1 hour chart on the GBPUSD how quickly these market types can reverse.

Bear normal market types

Bear normal market types can be identified by the price trading below or along with the lower Bollinger band and the 3 period moving average remaining below the 7 period.

You can see a bear normal market here quite clearly on this daily chart of the EURUSD.

The strategy

The strategy for a bull normal market type is to sell rallies or sell breakouts after a period of consolidation.

Here you can see a period of consolation during the trend above that can identify by zooming in on a 4 hour chart.

Bear volatile market types

Bear volatile market types can be identified by the large candles trading outside of the Bollinger band.

The strategy

Similar to the bull volatile market type, the bear volatile is a difficult market type for entries. But if you do find yourself in one, as you often will, then keep your stops tight to guard against the reversal. This will allow you can capture profit if the move continues and allow you to keep hold of the majority of your profits if it quickly reverses.

Sideways Quiet Market Types

You can identify a sideways quiet market type by the Bollinger Bands tightly coiling around the price. This can be seen here on the weekly chart of the EURGBP.

The Strategy

Breakouts from sideways quiet market types can provide excellent risk/ reward trading opportunities. Be patient and stalk the breakout like a hunter stalking their prey.

Sideways volatile market types

Sideways volatile market types can be identified by expanded Bollinger bands that are moving sideways and the price contained within the range.

You can see the EURUSD here is in a sideways volatile market type.

The strategy

There are some excellent trading opportunities for range trades during sideways volatile market types. Wait for the edge of the range to be penetrated and the price to reverse back inside before you place the trade.

Over to you…

Learning to correctly identify the market type and then apply the right strategy will have a significant impact on your trading.

Time to take out your trading plan and note:

1. How you will identify the market type
2. How you will trade it