RAMBLINGS OF A FOREX JUNKIE

S E N E C A   P I L O T

2 0 1 3

First truth.
The trader must learn to take losses.

If you as a trader are unwilling to take a loss you will eventually take the mother of all losses. If the trader is unwilling to take a loss he or she will be forever closing trades with tiny gains that will never overcome their losses.

This was my hardest lesson. I consider myself a pretty smart person but this one was EXTREMELY hard for me. The natural tendency for me was to move the stop to breakeven as soon as the trade was into a decent profit. Of course the market will often roll over take out your breakeven stop and then race off to the target. You spent lots of time designing your method, you spent lots of time testing your method, set your stop and target and close the computer if you have to but **you MUST be willing to take a loss.**

I cannot stress the importance of this enough. Once I had a method with a positive expectancy this was the key for me to becomming profitable.

Ok I know its a lot of indicators but here's my chart set-up.

Junky, indicator laden charts will only increase indecision. Most people go down the indicator road. I certainly did. I still waste an hour or so a week adding one checking it out and then deleting it after a little testing. They all lag and they all will give you conflicting info. If you really want to confuse yourself throw up a bunch of indicators and then use multiple timeframes.

Everything you need to know to trade is on the chart I am posting. If the stochastics line up with my entry its purely coincidence.

If this trade works out, great, but the point of this post is not the trade its the chart. Its clean, uncluttered, and shows what I need to know.

1.3045 is the hurdle. If it gets past there the target is an easy walk. Anyone want to guess why the target is 1.30675?

Next hurdle 1.3054. Why? Its the current day high, that's an important number.

Ok, now I move the stop to lock some profit. Only after getting this close will I do this. I think getting within three pips of the target good enough to lock some in. The target price is the decision line for bulls and bears so it is pretty heavily attacked from both sides.

Ok profit taken at 1.3065. Wanted out before market open.

1% risk 3.8% gain.

Todays truth: Indicators are worthless and are not needed.

On Mondays and sometimes Tuesdays The bulls and bears are deciding whether the week will be up or down. The decision points are the two lines on the chart I posted. It isn't the purpose of this thread to go into trade strategy but I will trade around this area all week. I will use these prices for targets and entries.

Price is everything. Price at certain times is gold. This will lead into truth three.

And there is the target. Now Who wins Bulls, or Bears?

One thing about the decision points. Sometimes they are hit early Monday during Franky or London and never touched again. So I don't necessarily trade these price points every day. They are guides though. **Typically long above and short below.** I wish I had the patience to long or short off these areas and hold it for the week but I cannot seem to do it so I have adapted a short term strategy using these areas as a guide. Since trading is fractal the same principals apply on shorter time frames using daily levels instead of weekly. Again I wish I had a longer term view Because I would like to sleep through London and take one or two trades a week. I still only trade six or seven times a week and the returns are probably the same but I am lazy enough to want the longer term trades.

I am currently working on the longer term stuff on demo. I am hoping maybe I can use it in my investment account. I don't see ever being able to use anything longer than fifteen minute in my income account. Maybe one day I will mature enough to hold a trade longer than a couple of hours. :-)

I am done for the day. London close soon and all the volume goes away.

Truth three: Time actually does matter.

There are very important times during the day. The prices at these times are crucial.

It is important to understand I am saying time frames are not important, but prices combined with time are crucial. You can trade on any timeframe as long as you are trading the right levels.

A good trader would have gotten the target I posted today. A great trader would still have been long into the supply level at 1.31049.

I hope to someday be a great trader but you don't even have to be good to make a living only adequate. Unfortunately it takes many years and lots of trial and error to become adequate as a trader. I am still trying to learn every day. Its part of the reason I started this thread. Helps to noodle this stuff out in a rambling thread.

Trading truth:

Open a chart. It looks like there is endless opportunity. Price moves up and down over large areas with trends and in ranges. Looks like you could just trade anywhere if you have a good "system". Don't get sucked in. It looks great but its dangerous. It is important to identify high probability entry points. This is another way to dismiss indicator based systems. Indicators will constantly make you enter in no mans land.

The truth: You must identify specific places on the charts to place your trades and ignore all the area between these points.

The chart below has areas identified. The lines are just stuck on randomly so don't try to read anything into them. This illustrates the need to be selective and patient in your trading.

Notice in the top no trade zone there is a killer pin bar that looses. If you are sticking to your narrow trade areas you would ignore this trap.

I added a stochastic to the chart to illustrate What I am talking about. If you as a trader insist on using indicators, please don't just follow them blindly. The entire length of no trade aone two has the stochastic in oversold territory and showing divergences. Ignoring this will improve you trading.

There are many ways to identify trade zones. Some traders use horizontal S&R, some use supply demand (Sam Seiden is a good search for this), trendlines, and etc. The lesson here that I had to learn the hard way is, only trade in areas that you have tested and proven give you an edge.

I want to say at this point that there is one indicator that I live by. It is the ATR. You cannot set a stop without it in my opinion. If the trader set stops based on some round number that sounds good they risk too many stops or stops that are too wide and cause losses to be too large. Imho ATR based stops as a percentage of daily moves are the only correct way.

I was reading a thread this morning where the trader had ten pip targets with one hundred pip stops. This guy was trading OPM. A simple ATR study would probably show that once the market moved some percentage of ATR against his position (perhaps 30-40%) he should close. With a hundred pip ATR this trader might save himself some serious losses. Personally I would never trade a method with a R/R lower than 2-1 but some people are winners with R/R <1. This trader however has to win over 90% just to beat the spread.

I post MT4 charts. MT4 is a wonderful charting platform. It sucks for trading though. I am lucky that my broker has MT4 as an option. I am able to trade on the in house platform which has excellent instantaneous fills while using MT4 for charting and posting. Every time I try to trade form their MT4 the fills take nearly a second, terrible. With my broker I can simply trade on the in house platform from my MT4 enabled account and all the positions show on MT4 so I can print out the trades for my journal.

My recommendation, don't trade from MT4.

A truth for today.

Normal market movement (big fundamental news events excluded) is simply to facilitate orders. The market moves up purely to find sellers. The market moves down purely to find buyers. Put up a chart, locate the likely areas where there will be buyers and sellers and you will see reactions at these places. The market won't move for your or my five lot trade, but it will shoot up at blinding speed to fill a sell order for billions. Large orders need lots of liquidity. This is why you will often see price rocketing up or down only to bang against a level and then reverse hard. The simple way to find the needed liquidity is to get the price moving hard. A big buyer or seller can count on bad retail traders to buy what they are selling because the novice trader loves to buy big green bars and sell big red ones.

To get a true understanding of these concepts the trader should study market structure. There are lots of free pdfs. and other imformation on market structure on the web, and best of all its free.

The simplified description goes like this.

Big seller at 1.25375
Market at 1.25225
Banker wants to fill big order so he first puts his sells at 1.25374
Then banker puts market order large enough to cause a minor breakout (takes less money than you think).
Breakout players jump in pushing price higher.
Momentum players jump on board (scalpers, indicator junkies, etc)
Price races up into the really big order at 375
Price reverses.
Price action players jump on the pin bar.
Momentum players reverse their positions.
indicator junkies get stopped.
Breakout players are short now.
Price races down to find the next big buy order.

Cycles over and over.

A chart to illustrate, The levels don't mean anything just picked a day at random.

Q - *I understand that the highest volume of trades occurs during the London and London/US open sessions, but what do you mean by "the prices at these times are crucial"*

I will give you an example then you can do some investigation and find more yourself.

Put up a cable chart. GBP/USD fifteen or thirty minute.

I don't know your time zone but just put a line on the chart reflecting the price at London close. (noon US eastern time zone)

Now look at how price reacts to that line later in the day. Many times, not always, price will bounce off that line during asia and during Frankfurt and London.

That is price at an important time.

A chart might help illustrate.

Wish it was this easy every day. :-)

There was a fourth trade, can you spot it?

I want to make three points that chart illustrates very well.

1)All three of the trades illustrated are counter trend and noone was sliced by a falling knife.

2)You don't have to make fifty trades a day to have good success.

3)You will know you are really trading with a good method when most of your trades have their entries fall within the wicks of the candles. The best methods have small draw downs and spend very little time around the entry price.

Q - *What does this mean? I can't visualize what you are describing here. Which candles wicks, relative to the entry?*

This

On Monday morning at 8:30 I posted a chart with two lines. I said I could use that to trade successfully. Here is the same chart today. Same two lines.

I changed it to thirty minute so I could show the whole week.

I said those two lines were the decision points for the week.

Believe me now?

I want to celebrate my 100th post.

With a truth.

Trading is simple... It is definately not easy, but it is simple. :-)

If it isn't simple: If nine things have to line up before you can make a trading decision: You are not doing it right.

Also I am taking tomorrow off from trading. I got flat on the huge spike and feel like taking it easy.

I may drop in to chat a little but not during London, I'll be asleep.

Good luck and lots of pips everyone.

Q - *If you are drawing lines off the London Close each day, how long would you expect them to stay active.ie., how long do you leave them on the chart? Is it just for the next days trades or much longer?*

I only use until the next London close. Update each day.

These prices are great for scalping if you are into that sort of thing. Price usually reacts off these prices at least a few pips and often a lot.

London close is one of several valid price levels I trade each day. I don't intend to go into trading too deeply in the thread but if you spend some time with charts for each pair, you will begin to see patterns that center around certain price levels throughout the day.

Psychology is vasty Important in enabling the trader to stick with winners until they reach their target. Psychology is also critical in helping the trader to cut his or her losses quickly without reservation. If there is any holy grail in trading it is these two fundamental things. Cutting losses and riding winners is critical to success. Many losing traders actually try and or purchase methods that work however they are not mentally prepared for the games trading plays with your mind.

People are taught from a young age in school that anything less than 90% is failing (less than A). Many people are very competitive and therefore do not like to be wrong. Trading is a bit different in that often a winning strategy may rely on a low win to loss ratio. Many very profitable methods have win rates in the 40 or even 30 percent range. These methods rely on cutting loosers quickly and riding winners. Our psychology often is that a losing trade equals a failure when, in reality, it is not a failure but simply a losing trade. Many novice traders view a losing trade as failure and simply won't close the trade hoping instead that it will come back. Often with a novice trader there is a tendency to fear loss and any trade that goes into profit is quickly cut at breakeven or for a tiny gain. Many traders never get past this stage as they ride loosers and cut winners until their account is ground into nothing.

If you are one of the people I have described here is a little exercise I used to help get past fear of losing trades. Open a small account, 50.00 is fine. Oanda works well because you can trade any size position. Open a fifteen minute chart any pair is fine. Any time the current bar exceeds the high of the previous bar then turns red go short. Do the opposite for long trades. Stop is one tick above the high or low of the current bar. Trade size is one hundred units, penny a pip. You will take many losses with this and it will teach you to kill them quickly. After a couple of weeks of this exercise you should be comfortable with losses. You hold the trade until you get an opposite signal, which should help you to learn to hold winners. THIS IS NOT A TRADING STRATEGY IT IS ONLY AN EXERCISE IN DISCIPLINE.

Now that I said all of that: THE TRUTH:

Psychology is important but only if you have a winning method.

If you KNOW your method will win only then should you begin to train your mind. Having a great psychology is useless if practiced on a losing strategy. The holy grail of trading is to know without question that the method you trade is profitable. Only when you KNOW the method works will perfecting your psychology help you to improve.

Side note:

I still have the tiny account with Oanda. Opened it in 2009 and still use it to try out new ideas.

Leads to my last truth for the week.

You can do anything on demo, but it doesn't mean a thing until you have REAL money on the line.

The truth: Demo accounts are really worthless but a micro account is Priceless.

Important price levels generally hold because that is where traders place their orders. In one of my earlier posts I described the way I understand price moves from level to level. Brokers and banks must fill these orders to get paid and they have lots of money and strategies to shade price into these levels. Think of these areas on a chart as a huge stack of sell orders and a huge stack of buy orders and only uninformed traders trading on tasty looking price bars in the middle. Of course nothing is 100% accurate, but to make really good money all you need is a reward to risk around 2/1 and a decent win rate. If you are happy trading on the daily time frame you can use monthly and yearly levels to trigger your trades.

Gator uses many of the same levels I do but he also uses levels that are quite old. I am not sure his time horizon but I imagine he trades some short term and some longer. He also seems to be successful using pivots but I don't believe in them. A pivot is simply a mathmatical formula using a previous range. I prefer to only trade using a price level I believe will be a place traders (large and informed ones) will be placing their orders. Daily closes is one of those levels. I feel that to be successful at trading it is critical to eliminate from your screen anything that will distract from these critical levels. I also understand though that my way isn't the only way and many successful traders use pivots and fibs and have found a strategy to use them profitably.

I was a James 16 fan when I started Forex and it is a profitable way to trade but I hated the drawdown that is so common to trading bar breaks. With Futures I had used pivots and had marginal success but knew there had to be something better but I never found it. It is when I started to dig into how pins and other price action bars form and investigated the levels that were within their wicks that I really learned to trade. A pin bar trader can be successful but the guys really making the money are the ones entering five or six pips from the top of that pin well within the wick. A big turning point for me was finding Sam Seiden in my investigation. The understanding that orders are what really move the market set me on my path.

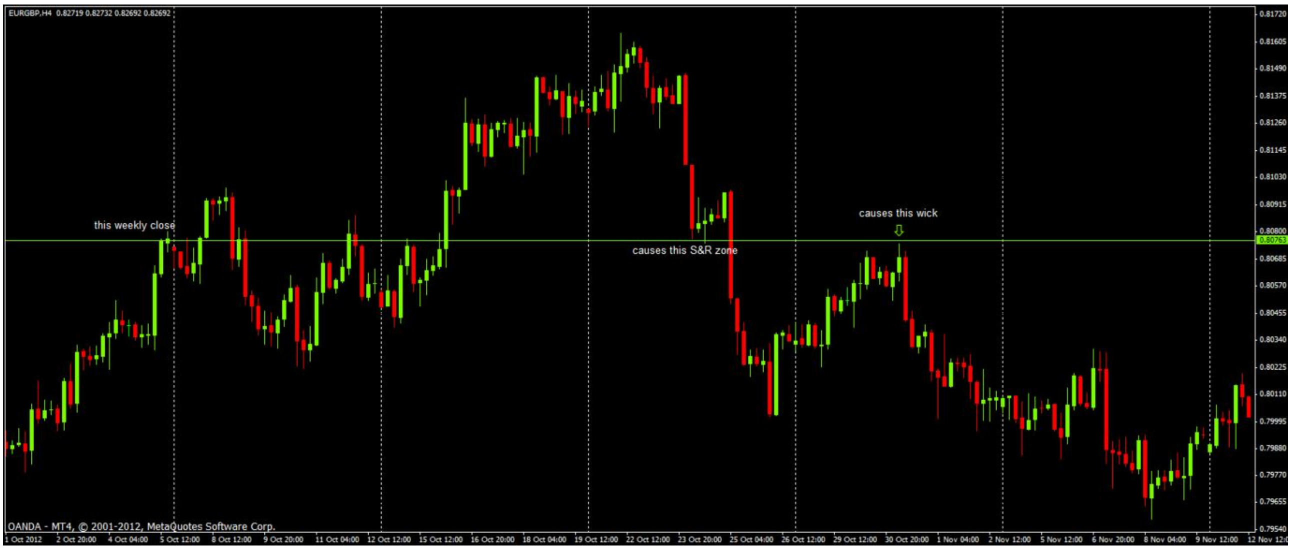
For fun, open a chart and start marking what you feel are important support and resistance areas then scroll back and see if those areas line up with an important price level. S&R itself doesn't really mean much but something had to cause price to turn at those levels. It's kind of a chicken or egg proposition because you can trade S&R without really knowing the mechanics behind it but I like to know exactly why I am doing something.

A chart example might help paint the picture:

Q - *When you say you look at these smaller areas, what are you using to actually "confirm" that an expected reaction is taking place?*

It isn't so much that I am looking at levels within wicks but that levels cause the wicks in the first place.

Another chart example:



Also note that this level is the .75. Well known in trading that orders often stack up at 00/25/50/75 levels.

Q - *What is an entry signal?*

First point: It is very easy to draw S&R in hindsight, in fact the zones are everywhere and they are constantly violated and or respected. In the example chart I posted for Kanzler however you will notice that I only highlighted one level. Lots of time staring at charts and testing to find levels that hold show me the levels I want to rely on. This is something that is going to be personal to each trader, I am simply trying with this thread to help people to learn to make these choices.

With regard to trading these levels, that is up to each trader to decide. Some might choose to trade bars around the level (pins engulfing etc.). Some might simply wait for a rejection or a close past the level then enter on retest. Personally I have tested the levels enough, and I am picky enough that I am a touch trader. It is the most aggressive style but the entries are normally the best and through much testing I know how far the price should move past my level before I stop it out. I have also tested well enough to know that once I stop out I normally get a retest of the level to enter in the opposite direction and that normally the profit on the reentry will give my normal target plus the stop distance. The way I trade is definately not for everyone, you have to be comfortable to jump in front of a moving train and comfortable to take a loss without fear.

I will not reveal all my levels. I have the shown the weekly close twice so that is a place for people to start. There are other levels and they can be found with some hard work. I will say that all my levels are based on a specific price at a specific time. I do not trade levels that just pop up on a short term chart throughout the day.

You are right there are many "S&R" levels on any chart, the trader's job is to research and locate the ones that hold often enough to make a trading strategy.

One more point I would like to make with regard to price level trading. As with any other type of trading method we will never achieve 100% accuracy. Historically I have 58% winners and I average about 1.8:1 reward to risk. I am right only a little over flipping a coin if you think about it. It is definately enough though to make a comfortable living.

Some things one should think about if they plan to begin the journey to learn this trading style:

What are the important times during the day for my chosen currency pair.

What are the important price levels throughout the day for my chosen currency pair.

What is the base currency in my chosen currency pair and which markets might be more likely to print important prices (London, NY, Asia, etc.)

Which markets will it be more likely that I will see reactions for my levels. (ex, are we really trading GBP/JPY after London close and before Tokyo open?)

Have I studied the distance as a percentage of ATR my trade should travel before I should stop it out.

There is more but this is certainly enough to study for the coming weeks.

Why not this level its S&R right?

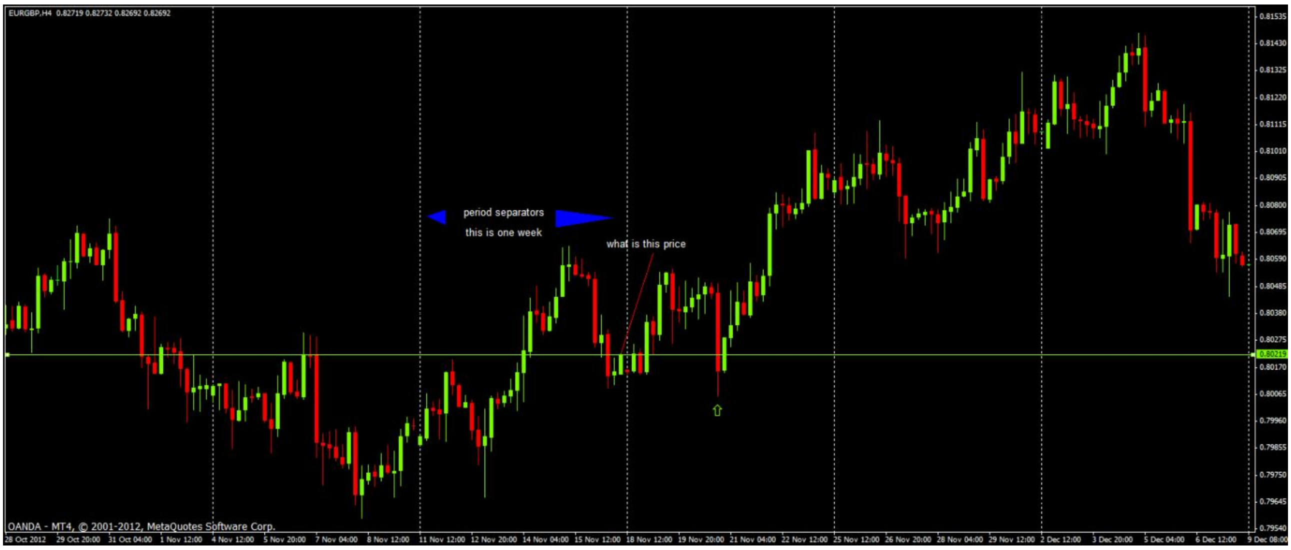
Scroll back and ask yourself is there a specific price supporting that level or is it just something that appeared.

Posting a new chart here, has another level. I took this trade. Look hard at the level, why would I have had the confidence to step in front of that train. I can tell you it was cooking with gas when it hit my level. I only was using 20 pips plus spread stop with the ATR at the time. I can tell you that the way price was moving at the time I could have easily bought fifteen or twenty million and not even slowed the price down. The draw down was only 17 pips. you can see the profit potential was over 100. This is how the market operates. Big traders need liquidity and that was a price level where big traders trade. Why? Where are stops here? Will Large traders use stops to get long or short? Have you googled market structure and started studying yet?

Not trying to be an azzhole here I just want to get you thinking about what levels are really important. Every S&R on the chart is not trade worthy.

Marked a chart. **Remember I don't trade S&R I trade prices. Specific prices predetermined at specific times.**

Also London closes at 12 eastern.



Search order flow on this site and you can find some good papers to study if google doesn't turn up much. This is hard to find as it is gold and not easily given up.

http://faculty.haas.berkeley.edu/lyons/Vitale%20survey%20micro%20FX.pdf

http://www9.georgetown.edu/faculty/evansm1/wpapers_files/tour.pdf

I am a touch trader.There is basically no decision to be made once i place a line on the chart I will take the trade whatever the speed of the market. In fact

I am more afraid of a slow grind into my level than a quicker move with a larger bar. I pick a level and go with it. I trade daily, weekly, and monthly levels but rely mostly on daily. I typically have three or four lines on the pairs I am watching and once I take a trade I generally target another line for taking profit. Sometimes a trend will stop and reverse on some of the longer term key levels. As I said before I am not a long term trader. I have not learned to hold trades for huge gains. I am trying to learn it now in my tiny experimentation account. I would love to make two or three trades a week and watch them run but for now I don't have the attention span. I am a day trader and my profit horizon is typically thirty to eighty pips.

The only thing with fundamentals would be Big and or Unexpected news events. Last week for example it was widely expected that Draghi would cut rates until the data began to get better, clearly about wed night things changed. I was long Thursday off a level but I would never have shorted that market no matter the type of level.

A common strategy is to bracket a range of prices and then trade a breakout of the area. Big ben, Big dog, Asia channel, and opening range are a few of the popular variations on the theme. The problem with these strategies is that price often breaks out and then quickly retreats back into the range and goes to the other side. Most of the strategies for these methods call of a stop and reverse when the other boundary is broken. It is very common to have multiple losses on rangy days. Most of the threads you will find discussing these strategies usually have as an answer to this problem to simply set your take profit at ten or twenty pips. Meanwhile the stop is back on the other side of the range forty or fifty pips away. The win rate has to be way too high to overcome the inevitable losses.

Here is a simple answer to the problem. Wait for a real breakout. Here is a tested and profitable strategy using levels with closes and retests.

EUR/USD chart one hour

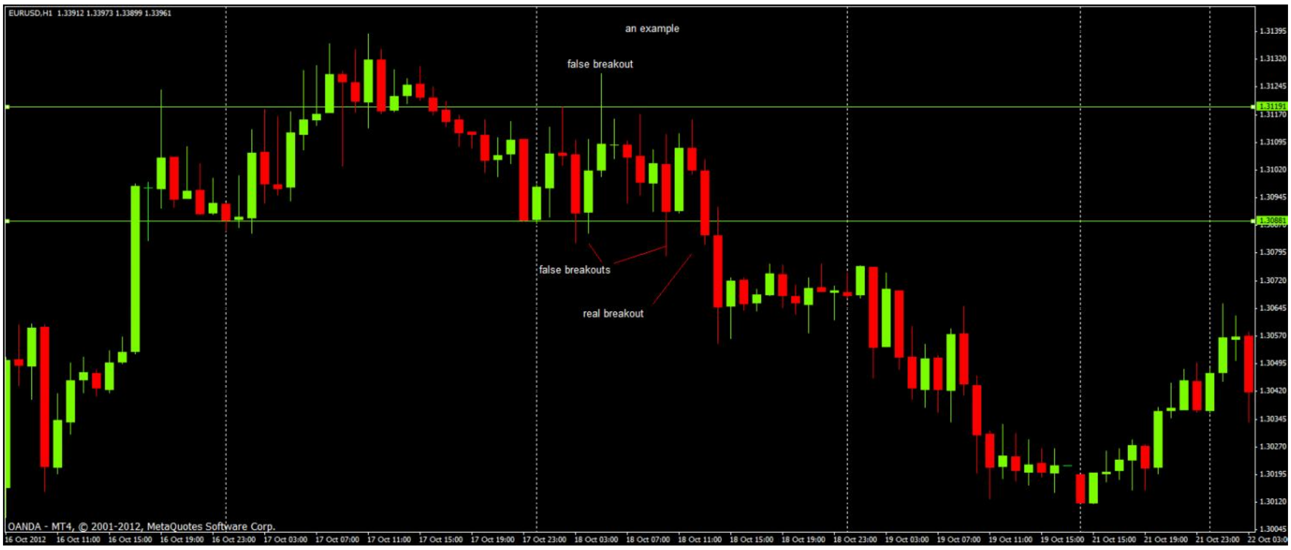
Put a line on the high and low between the hours of midnight and three AM Eastern. You are bracketing three hours leading up to London open. Now you are going to trade the breakout but lets define our breakout. We need a close of a one hour bar outside our range. Once we have the hour close outside we place a pending order back at our line. Target is minimum 1 to 1. A good strategy is also to target a larger gain by splitting your entry into two units, take one unit off at 1 to 1 and use a larger target for the second unit with a BE stop.

From May 2011 thru Dec 2012 this strategy had 105 trades. Sixty six were winners, thirty nine losses. 63% win rate with 60% gain on equity.

The Truth:

If you are going to trade breakouts Only trade CONFIRMED breakouts.

A chart example



Poker and Trading are remarkably similar. Both pursuits are skill based speculation with a large short term luck factor. When you make bets in poker you are speculating that the large number averages are in your favor. There is very little luck in the game of poker over a long run if you are a proficient player. On any given hand, however luck plays a very big factor. In hold-em excellent hands are routinely beaten with rags as the board develops. Over thousands of hands however the player who plays the better hands and avoids the bad ones will come out ahead.

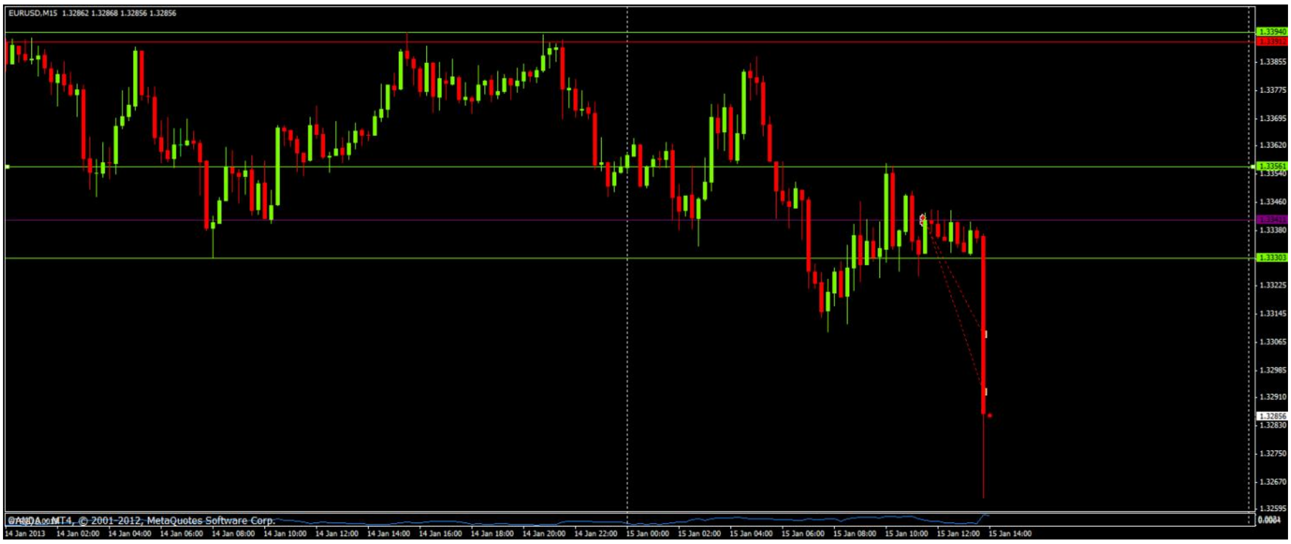
In poker, like trading the player has the ability to change the outcome throughout the hand (trade). It is up to the free will of the player to pass, call, bet, raise, reraise, or fold as each new card hits the board. The trader faces the same type of decision process as the trade develops. The trader may choose to stay with their original position, add to their position, cut the size of their position, leave the position to the devices of the market, place a stop on the position, exit the position at signs of exhaustion, have a set profit target, have a floating target, take partial profits, etc.

This free will with respect to the decision process opens the door to many problems. Traders often will exit a winner at the first sign of any adverse price movement even though the movement may just be part of the normal ebb and flow of the market. Traders also often will exit a position at a loss before their stop is hit and while patting themselves on the back for saving the money watch the position turn around and move into profit.
Traders also will often move their stop to breakeven plus one pip prematurely and watch in horror as the stop is taken out and then the position moves into profit. These behaviors may be caused by a combination of factors. The trader may have seen a winner turn to become a large loss in his or her past trading. The trader may be afraid of losing profits that he or she has mentally tallied. The trader may be trading positions too large for their account size and not be comfortable with the loss a properly sized stop may inflict on his or her account balance. The trader may habitually trade without stops and take profits prematurely when not able to minitor their trade.

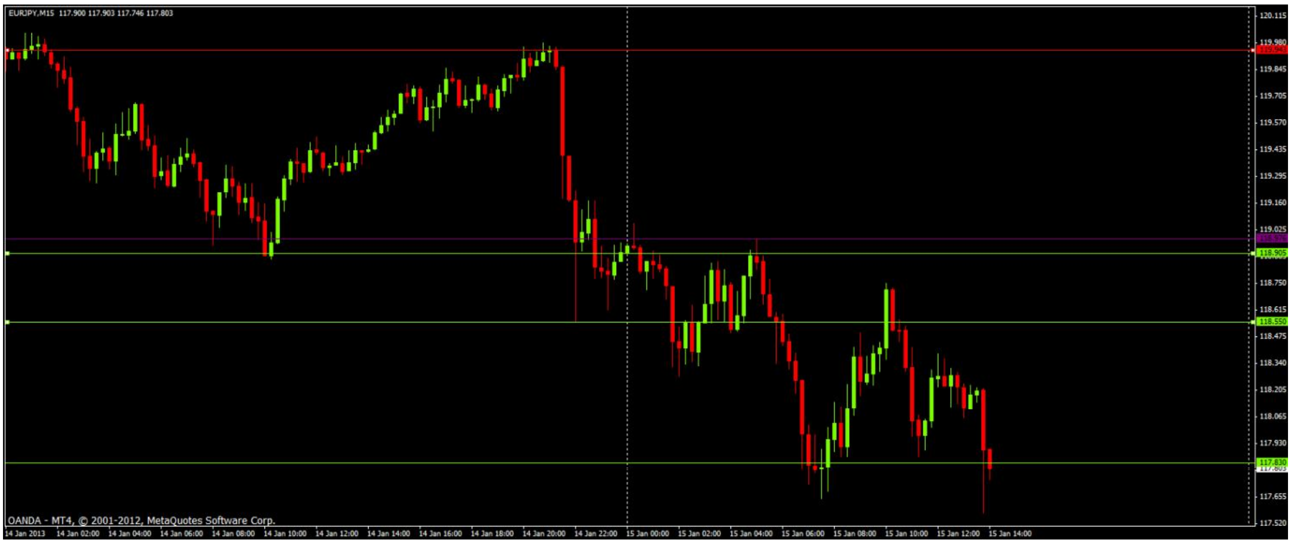
The obvious answer to these problems is to use a stop, size your positions properly, and use the appropriate stop distance from entry to allow the market room to breathe. I would argue that there is another factor not often discussed. In learning poker the player will eventually begin to study game theory and mental discipline. In this study the player learns that to deal with the inevitable losses that come with playing a game with such a short term luck factor he or she must learn to mentally divorce themselves from the money. One thing that helps with this is that poker is played with chips instead of actual cash. The player must eventually though come to the realization that money is only the way of keeping score in the game and cannot be thought of in terms of what it is worth to the player. In this respect trading and poker are identical. In trading you will never know the outcome of a particular trade when you enter just as you can never know if your aces will hold up in poker.

And now the truth:

In trading as in poker before you click on the mouse to execute a trade, you must divorce yourself from the money. It is after all only a means to keep score.



I got stopped on the first attempt from the bottom. It was the only stop out I have had this week (more on that in a few).The big spike up to the daily open was a wash and rinse. I wasn't watching the trade at the time or I would have reshorted there (is that a word?). When it fell back below though it was an obvious short again.



I use GMT-5 to determine my levels. My brokers have always been on Eastern time zone. I am sure that using GMT with a little time you could locate the important areas you would want to use. Some of my levels do rely on my time zone but most are using times that would be universal. Highs and lows are determined by the time zone you trade so you have to experiment and find the ones that work for you. For the most part the time zone will change the trades but not change the results of the strategy. Today on EJ for example the lows traded better in your time zone than mine, some days my time zone will work better than yours probably all even out over time.