

Zero Sum Fun

Lite Version

Understanding The Game

Zero Sum Market

Forex trading is what's known as a zero sum game, what this means is one person's gain is another person's loss, if you place a trade and make £10,000 that money has come from other traders who thought the market was going to go in the opposite direction to you, if you lose £10,000 other traders have basically taken that money from you because you got the market direction wrong, this is true for everyone in the market, it doesn't matter if you're a professional trader or a retail trader, if you trade from home or in a bank at the end of the day one person's losses equate to another person's gain.

It doesn't matter what strategy you use or what type of trader you are, scalper, swing trader, position trader the only way you can make any money is if you take it from somebody else.

This is something a very small percentage of traders understand yet remains the most important fact of the forex market.

Trend - A Load Of Bullshit Spread To The Masses

This is going to be somewhat a controversial topic because the concept of trend is deeply rooted in every trader's mind, it's probably one of the first things you learned when starting out trading the markets, unfortunately the trend, with its most popular definition and understanding, has been made to make you lose money here's why.

For a trend to exist the market has to move a certain distance, until the market moves sufficiently enough in one direction nobody sees a trend.

If you don't believe this to be true then let me ask you a question:

When does a movement become a trend ?

Defining A Trend

The most common method of analysis traders use to define a trend is looking at higher highs and higher lows (in the case of an up trend) or lower lows and lower highs for a downtrend, there's nothing wrong with this method apart from the fact that its late in determining when a new trend has begun.

Think about this, when do you see that a downtrend has changed to an upturned ?

When the market makes a higher high and a higher low.

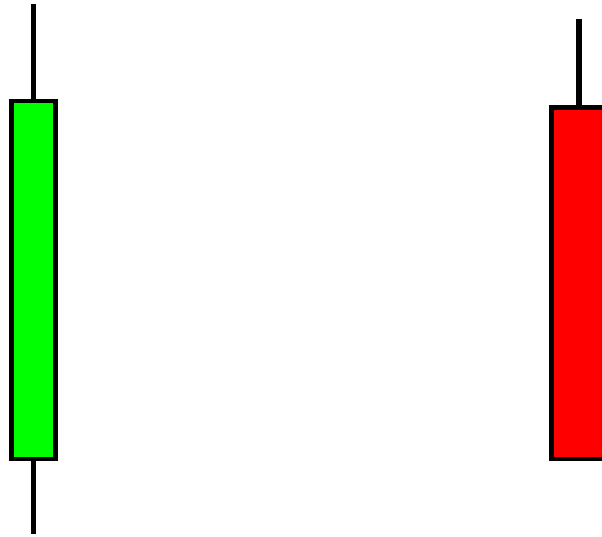
Easy to understand, yet flawed in it's execution.

Its almost like using an indicator. The reason for this is because the market has to move in order for a high or low to be broken, so until that happens traders will look at their charts and assume that the current movement is still part of the previous trend, this means their going to be trading in the wrong direction.

The other way people define trend is by seeing large range candles.

Large Range Candles

Large range candles are candlesticks that show a large price change has occurred in the market.



These candles are what define a trend, without large range candles it would be pretty difficult to clearly see which direction the market is trending in.

Now since most traders define how strong a trend is by these large range candles, they play an important part in how the traders perceive what's going on in the market.

We'll come back to this later.

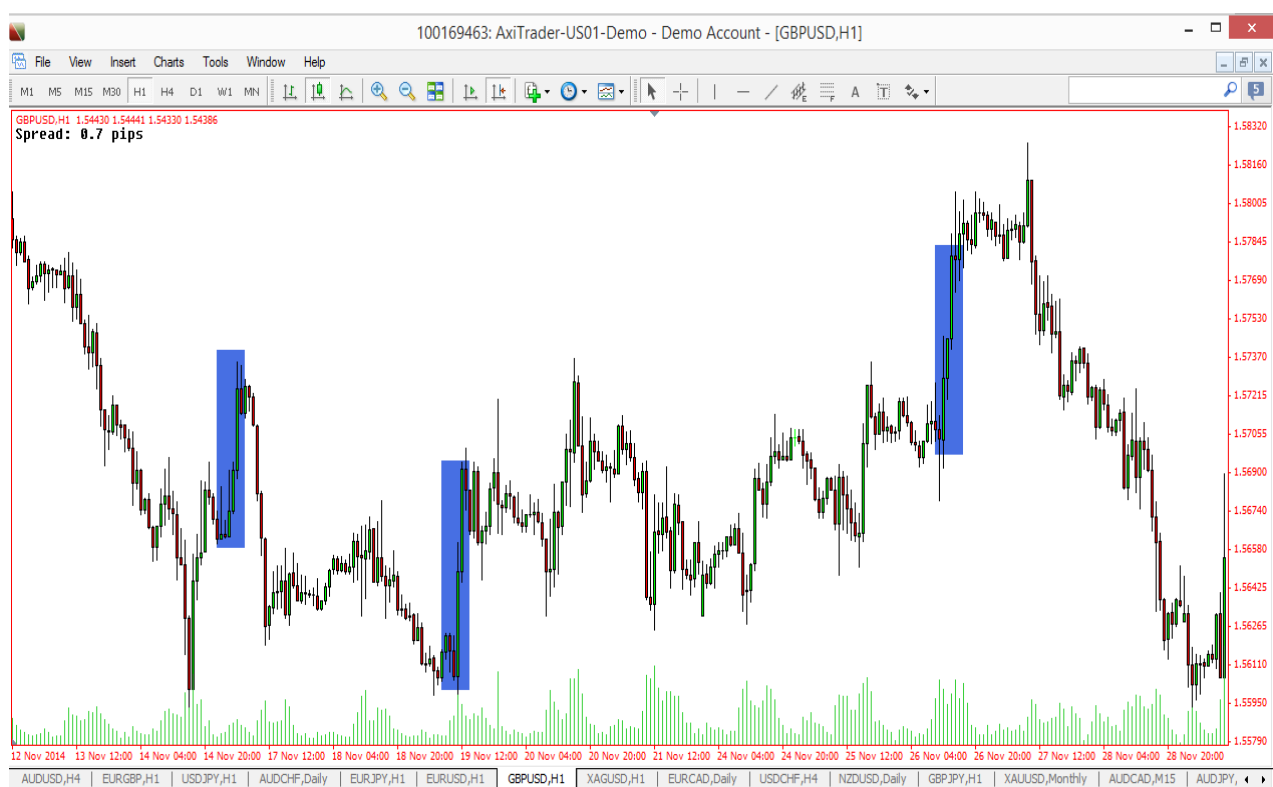
One thing that's important for you to know is that a large quantity of traders will place trades when they see these candles.

The reason they place trades onto these candle is because their have reactive personality traits in regards to their trading.

The traders trading these candles are not placing trades based upon any rational or logical method of technical analysis but instead on emotion, fear to be specific, they see these candles and believe that if they don't get in the market now then they are going to miss out on making money.

The size of the large range candles has a dramatic effect on the psychology of the traders watching them develop on their charts.

The bigger the size of the large range candle the more certain these reactive traders become that the market is going to go up or down, this why when news events are released typically it will produce a large range candle with high volume, the volume comes from the reactive traders placing trades who have just seen the market moving quickly and decided that its definitely going to continue in that direction.



These movements I've marked in blue are what reactive traders will typically see as trading opportunities.

Their drawn to these types of movements because in each case it looks like the market is moving up really strongly in one direction, take note of the fact that soon after these movements occur the market either stalls or moves in the opposite direction, this is purposely done to make the reactive traders lose money.

These reactive traders are present across all time frames too, don't

think for one minute that just because I'm showing this example on the 1 hour chart it means they're only active on this time frame, you can see these big movements with multiple large range candles across all time frames, the effect these movements have on traders are the same regardless of the time frame observed.

The Three Phases

All trends in the market consist of three phases.

Note:

My definition of trend is a price movement from one point to another without a significant pull back or consolidation taking place during the movement.

Phase 1 Imbalance

The first phase is caused by one set of orders coming into the market which are bigger in size than the current majority of orders causing the trend.

Example:

If EUR/USD is in an up trend on whatever time frame you're looking at it means the majority of the orders in the market are buys, suddenly out of nowhere a huge influx of sell orders hit the market which are bigger in size than the current buy orders, all the buy orders are consumed by the bigger sell orders and the market starts moving lower accordingly.

This imbalance phase happens at the beginning of every trend in the market no matter what time frame the trend is occurring on.

Phase 2 Liquidation

The second phase is called liquidation.

This phase is a result of the imbalance that occurs in the first phase.

The movement caused by one set of orders being bigger than the other causes traders who had trades placed in the opposite direction to the imbalance to close their trades at a loss.

These traders who are closing their trades add to the already existing pressure to the downside or upside, the movement generated by this liquidation of losing trades is entirely dependant on how many people were caught on the wrong side of the market.

Phase 3 Awareness

The third and final phases is called the awareness phase.

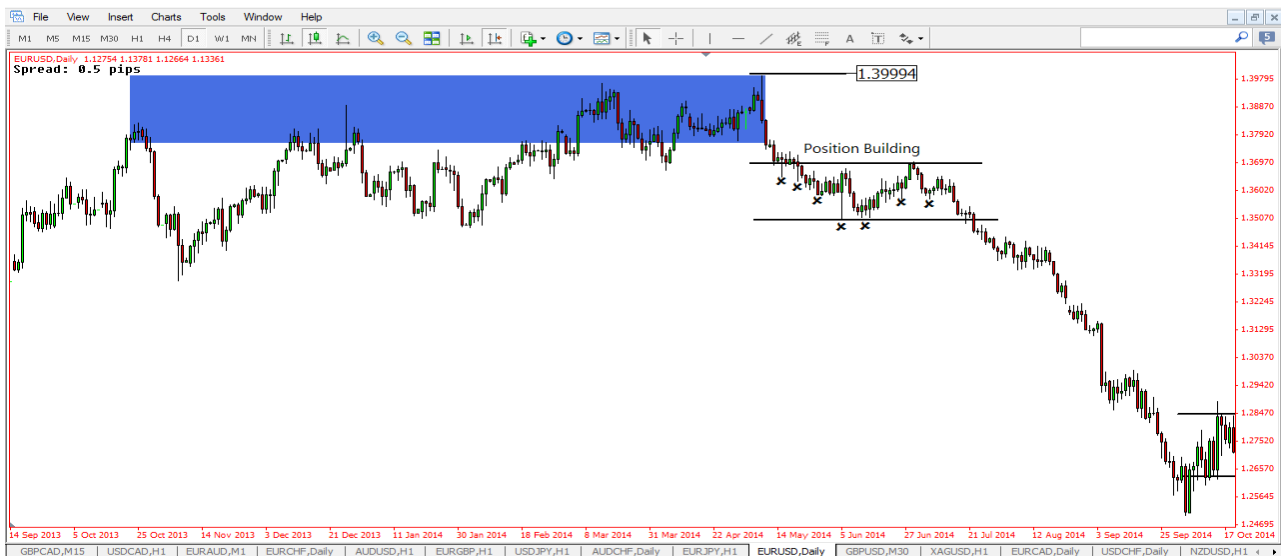
This phase is the sum total of the market movement generated by the first two phases. By the time the first and second phases are complete the market will have moved far enough for traders to identify the current movement as a new trend.

At this point all the traders who were caught on the wrong side of the market have closed their trades and are now beginning to place trades in the new market direction.

Quick recap:

1. First phase is caused by one set of orders being bigger than the other.
2. The second phase is caused by traders caught on the wrong side of the market closing their trades at a loss.

3. Third phase is traders becoming aware that a new trend is taking place because of the movement generated in the market by the first two phases.



The blue rectangle I've marked on the chart shows where a lot of traders would of been long from in the market.

The candle which nearly broke the 1.40 level and the one which follows it are a result of the sell orders being bigger than the buy orders.

How Do I Know This ?

Easy, lets look at the price structure of this down move on the 1 hour chart.

Thank you for reading the lite version of Zero Sum Fun - How To Profit From Losing Traders.

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