The Ten Commandments of Forex Trading

The 1st Commandment:
Thou Shalt Always Protect Thy Capital

Without capital, you have nothing with which to trade. Trading any currency, by nature, has risk involved. You have to risk capital in order to return a profit. It is not possible to be right all the time, therefore, you must protect yourself and your margin account (capital) at all times. You will have losing trades along the way, there's absolutely no avoiding them. However, proper margin management will assure your account will be there for tomorrow's trading.

Here's a simple rule:

Never have more than 2% of your margin account at risk at any one time, cumulatively.

Losing trades are part of trading, but keeping those losses to a minimum is crucial to success in the forex market.

Cut your losses quickly and let your winners run.

Always trade with a stop loss on your trade.

Studies have shown that traders who trade with stops make more money than those who do not.

If you are getting stopped out frequently the problem is most likely not your stop, it's your entry!

The 2nd Commandment:
Thou Shalt Always Trade With A Plan

It's a very simple concept: plan your trade, and trade your plan. Those who fail to plan, plan to fail, especially in the forex! Prior to entering any position, you should always have a trading plan for that currency. Only trade those currencies with a minimum 1:1 risk-to-reward ratio. Your trading plan must include the following elements:

- Scaled in entry points on resistance/support levels based on technical analysis.
- Stop levels that represent the correct risk-to-reward ratio and which always end in an odd number whose last digit is a three or a seven, such as 110.13 or 110.17
- Definition of the point where you will move your stop to break even, including enough to cover the spread.
- Scaled out exit points for profit at key resistance/resistance/support levels based on technical analysis
- Always have an identified target based on your technical analysis, preferably two targets.
- The number and size of lots you are currently willing to trade in the currency cross.
- Awareness of any upcoming fundamental announcements, the time they occur, and their potential affect on each trade being considered
- Wait for the trade setup and remember to **PROVE THE TRADE**.
  You may have a great setup and still not have a trade!

The 3rd Commandment:
Thou Shalt Learn Patience, Patience, Patience

You may have heard the saying "wait for the trade to come to you".

For intraday trading, the patience factor is the most important factor to consider before placing the buy or sell order.

You have to be "patiently" waiting for a currency to reach or break certain points before entering a trade. Having a trading plan for each currency is crucial, and that begins with patience. You must wait for an entry that maximizes profit potential based on your own technical analysis and trading plan rules. Only then should you enter the trade. **Master the "wait" trade as part of your trading system**

The 4th Commandment:
Thou Shalt Scale In or Scale Out

You should rarely enter a full position on a currency in one order. It is more appropriate and profitable to scale into a position initially rather than placing 100% of your available lots on the trade immediately. As your trade begins to lose momentum, you should scale out of the position. Scaling in is the practice of placing two, three or four planned entry executions in a given trade at the appropriate price levels. Scaling out is the practice of placing all of your lots into a trade initially and removing them in halves or thirds as profits are realized.

You should look for several entries at key areas of resistance/support levels, trend lines, fibs, or other targets on the charts. The first trade always carries the most risk. If your first entry is wrong you will be wrong small if you scale in on the initial position. Scaling in and out of your entries helps you to avoid tying up too much margin account capital in one currency at one time. For example, if you enter a full position of 3 lots in a currency by executing just one 3-lot trade rather than 3 one-lot trades, your capital is tied up for the duration of the trade. By scaling in, you reduce the amount of time the full amount of your capital is tied up in the trade.

To avoid unnecessarily tying up the capital in your margin account, your best strategy is to break your trades into thirds.

- If you are currently trading 1 standard lot – **QUIT IT!** Trade 9 mini lots instead, entering with 1/3 of your lots, adding the other 2/3 only after the trade proves itself.

- If you are currently trading 1 mini lot – **QUIT IT!** Trade 9 micro lots instead, entering with 1/3 of your lots, adding the other 2/3 only after the trade proves itself.

By using this strategy you have many more entry and exit options. Scaling out of a position serves two purposes. First, it allows you to increase your total gain and free up margin account capital *while* you are trading. By taking profit on half or a third of the position at the first resistance level, you can hold the remaining position for a larger gain, while minimizing the risk of a losing trade. If that resistance level is not broken on the first attempt, and the currency retraces, you can add another position, or simply keep the remaining original position for an eventual breakout above/below the support/resistance. The second purpose of scaled exits is to free up trading capital for other opportunities in additional currencies. This allows you to spread your risk around rather than relying on one currency pair. Always remember to keep watching your margin account balance so you do not violate the 2% rule in total as you are adding positions. Violating this rule could result in a margin call where all your trades are taken out.

The best plan is to trade for consistent, short-term profits, with occasional larger gains. Scaled entries and exits enable you to do several things. They enable you to enter at the lowest possible cost and thus have the lowest average cost. Scaling in allows you to have an initial position which will enable you to achieve your goal of short-term profit with a scaled exit on half of your positions if the first resistance/support levels hold. Scaling in also allows you to achieve larger gains by holding the remaining half comfortably. Scaled entries and exits are very closely tied to good margin management, as well as the daily trading plan you need to develop for each currency you plan to trade.

The 5th Commandment:
Thou Shalt Use Technical and Fundamental Analysis

The general consensus among traders is that short-term trading is based on technical analysis, while long-term trading is based on fundamental analysis. We generally agree with this assessment, but for intraday trading you need to rely on technical analysis AND keep an eye on the fundamental announcements which may affect the market. There are times fundamental announcements override technical analysis in currency behaviors, but in intraday trading technical analysis generally rules. You should make it a practice to get flat, i.e., have no open trades, whenever a major fundamental announcement is taking place. There are several online sources of economic calendar announcements from which to choose. Then, after the fundamental announcement is released, wait for the reaction to that announcement. If there is a strong reaction to the news your stops are not guaranteed by any broker, so it is safer to exit. You can always reenter the trade.

When examining technical analysis, look primarily for areas in the chart with as few barriers to your trade as possible.
These **"wide open spaces"** allow you to reduce your overall risk and still maximize the opportunity for profit. Once you have identified such an area, wait for our proprietary trade setup to materialize.
After ensuring you have a trade as well as a trade setup, do all you can to manage your trade and stay in to the predetermined target.

The 6th Commandment: Honor Thy Targets and Thy Stops

The purpose of trading is to make money. The best way to ensure this happens is to honor your identified targets when they're reached. The 1st Commandment of trading is to protect your capital. The best way to ensure this happens is to use stops, **always**. If you've established a trading plan for a currency, which you should always do, then the only way to execute that plan is to honor the parameters you established prior to initiating a position. Anything you change will change the original risk-to-reward ratio you used in deciding whether or not to enter each trade during your initial analysis.

The basic rule for the initial technical stop is to use the last support or resistance, plus 5-7 pips, using an odd number ending in a 3 or a 7, such as 90.13 or 90.27. Monitor your margin account capital so you also risk no more than 1-2% of your margin account cumulatively, across all open trades. Be aware that with fractional pricing, you may get a fractional difference in the spread at your stop which could trigger the broker closing your trade. Note that each time you move a trade to break-even you have released your margin back into your cumulative balance, again making it available to your 1-2% for other trades.

In the forex you have the ability to leverage your account in your trades. Leverage is defined as controlling a large amount of currency with only a small percentage of your own capital at risk, comparatively speaking. Since you can control a large amount of currency with very little or your own money, you can look for multitudes of opportunities as long as you do not break your margin management rules. When you trade you give the broker only a fraction of the total value of the trade. In 50:1 leverage, you give the broker 1 part; the broker contributes the remaining 50 parts. If you deposit $1000 in collateral you can trade $50,000.

If you trade without a stop, the entire $1000 deposit is 100% at risk. Should something catastrophic occur, such as an unplanned news event, intervention or fundamental announcement effect, your entire account may be reduced to zero. However, as soon as you put a stop loss in place, say 30 pips or $300 in this example, you have now limited your risk to only that $300.

Your stop is the #1 way to protect your margin. NEVER trade without a stop loss in place.

Honoring your previously identified targets is as important as the correct use of stops. Greed can quickly turn a winning trade into a losing trade. If you've identified support/resistance levels or other targets, and your profit goals are reached, then honor those targets by moving your stops tight and locking in your profit. If the currency continues to move, you are still locked in for the additional pips. The biggest reason for this, other than locking in profits, is a psychological one. If you **voluntarily close** a trade which then continues in the same direction, you will blame yourself for the lost pips. Over the course of time the psychological effect of such closes will alter your exit strategy. However, if your trade is stopped out **by the market** and then continues as before, that is just the market at work. There is nothing you as an individual trader can do about that. Successful trading requires maximizing gains, so you have to be willing to alter the plan. However, it is wise for you to close at least a portion of the position when an initial target is met in order to maximize your gains.

The 7th Commandment:
Thou Shalt Keep a Written Trading Journal

In trading you should learn something every day. There is always room for improvement. Trading has its ups and downs so it's important to achieve personal trading consistency. To accomplish this, you should prepare a written record of your trading and review it regularly. Examine each and every trade made and look at what you did right, what you did wrong, what you could have done better, what you missed which resulted in the trade turning against you, and so on. Analyze your trades and then apply these lessons to future trades. The best way to truly assess your trading is to keep a thorough log of your trades. Things you write down multiple times in a week are areas in which you need to discipline yourself. Example: If you write *"moved my stop too quickly"* three to five times this week, you know what you have to do next week - stop moving your stop too quickly!

Trading behavior often repeats itself. Over time, most traders teach themselves bad trading habits. Examples of such bad trading habits include buying too soon, selling too soon, giving back profit by not closing the trade, setting stops too loose or too tight, taking too many trades at one time, waiting too long to enter a position thus missing trades, being overly cautious, being overly aggressive, being in too many high-risk trades that turn against you, and abandoning a trading plan. When negative patterns develop and repeat themselves in losing trades, this causes frustration and has a horrible effect on your trading.

When positive patterns repeat themselves, and consistent, high percentage, winning trades are being made, it has a positive effect leading to a longer-term winning streak.
Being aware of these patterns and correcting them is crucial. The best way to do that is by keeping a trading journal, examining each and every trade with your log and your charts, and recognizing the behaviors as they develop.

By taking the time to review your journal, you can change your bad trading habits early in your trading career instead of letting them develop into an unbreakable pattern which will lead to consistent losses.

It's important to note that **all** traders hit a losing streak and will struggle at some point in their trading career. When this happens, it’s best to take a break from the market for a few days, then paper trade for a few additional days to regain your confidence. When you return to active trading, take smaller positions until winning patterns are re-established. Having and reviewing a trading journal can be a tremendous help in identifying and correcting your bad trading habits.

The 8th Commandment: Thou Shalt Not Force Trades

One of the hardest parts of trading is sitting on your hands and doing nothing. It's called "the wait trade." The majority of full-time traders, according to many research sources, spend more time on the sidelines not trading than they do in positions.

In the case of intraday trading, forcing trades may mean entering a trade too soon, prior to chart confirmation, or well before the parameters established for the trade have been met. This often arises out of the, feeling of "needing to be doing something." It may mean chasing trades up or down if several entries are narrowly missed, only to see the trade turn against you. There are times when it is simply best to sit on the sidelines, and wait for the best opportunities to come to you.

Forcing trades may also mean selling too soon over and over, which results in not maximizing your profits. As a Forex Trader, you may spend a whole day to several days accumulating positions without ever closing a trade. As your targets are gradually hit, you can lock in your profits and suddenly realize a very nice percentage return over that period of time. Try to avoid feeling the pressure of making sure you take some profit every day. There are really only 1-2 REAL opportunities per session. Even when you take one trade and scale in and out, it is still just one trading opportunity.

If you've established a trading plan for a currency, then let the trade come to you. Never force your way into a trade simply for the sake of trading. If you miss a few, so be it. Simply look for the next trading opportunity. There are plenty of currencies and a 24-hour a day market, so there will be plenty of future opportunities. The trade you miss is not the last trade in the forex. Forcing trades, however, can lead to sloppy trading, which usually ends in losses.

The 9th Commandment:
Thou Shalt Control Your Emotions

One of the most difficult parts of trading is eliminating emotions from the process.

The most successful traders are calm, analytical, and methodical. If you let your emotions dictate your trades, you will lose money, period.

Trading is basically calculating risk vs. reward based on a combination of technical and fundamental analysis.

There is no room for emotions in that process. The most common emotions which interfere with the process are fear, greed, indecision, stubbornness, and hope. The strength of your mental abilities **must** overcome your emotions for you to be successful in trading.

The 10th Commandment:
Thou Shalt Be a Disciplined Trader

There are many styles of trading. These include intraday trading, breakout trading, intraday pivot trading, momentum trading, the list goes on and on. The one unifying factor among successful traders, regardless of their style, is disciplined trading. Trading means taking calculated risks, and the only way to consistently make profitable trades is through practicing trading discipline.

Disciplined trading simply means obeying all of the first nine commandments. Intraday trading is a specific trading methodology. It consists primarily of the following: identifying key resistance/support levels; confirming there are technical reasons to trade a currency; accumulating positions through scaled sells/buys at resistance/support levels; using stops to protect positions; limiting your total investment in any one currency to protect capital; identifying buy and/or sell targets; and moving stops tight when targets are reached.

Simply stated, disciplined trading means executing the trading plan for each currency within the overall trading strategy, and doing so without an emotional response to the reasons for entering the trade, or an emotional attachment to the outcome of the trade

Without discipline, the methodology is disrupted, resulting in sloppy trading which leads to losses.

All traders establish rules for their trading. Undisciplined trading occurs when those rules are broken. Any successful trader will tell you that their performance is negatively affected when they break their rules and ignore discipline. The most difficult part of trading is exercising discipline and mental strength over emotions. However, when such discipline is accomplished, it results in consistent, positive performance. Plan the trade and trade the plan. The basic concept of trading discipline is quite simple and will result in positive results once mastered.