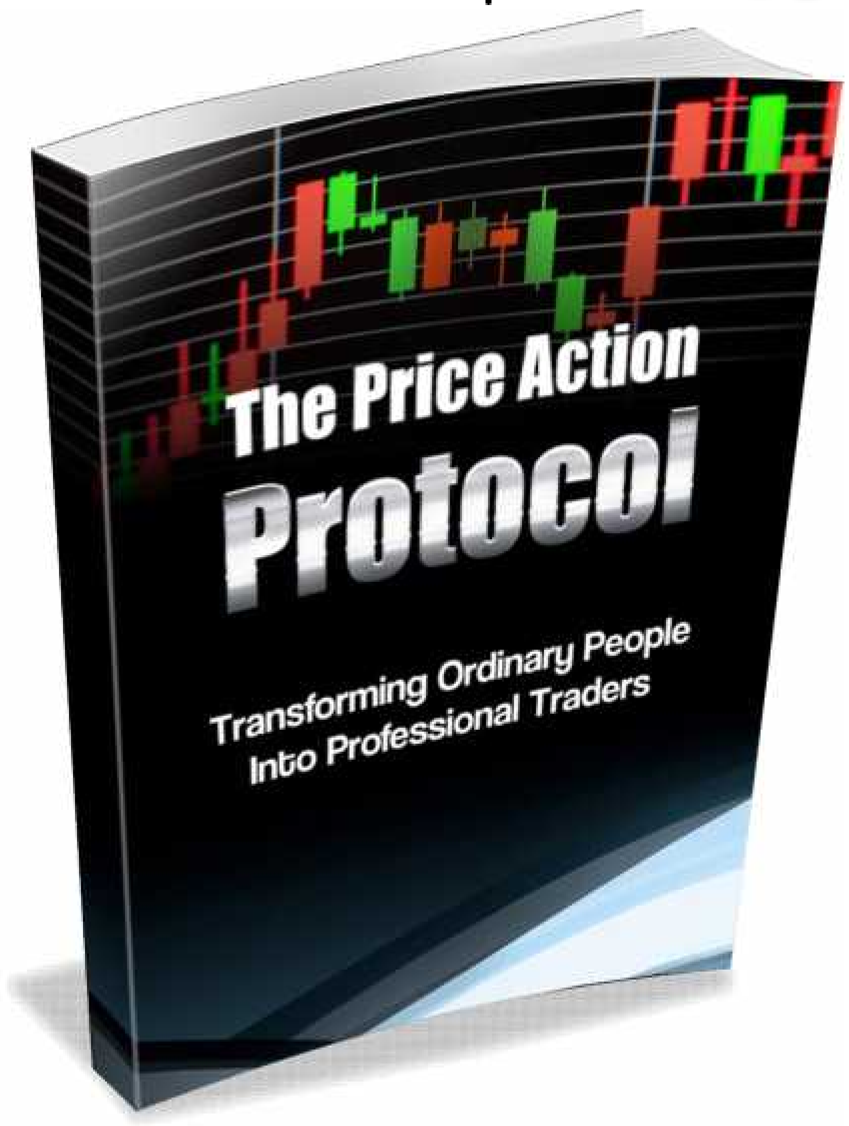
The Price Action
Protocol
Transforming Ordinary People
Into Professional Traders

Introduction

Hi! Thanks for purchasing "Dunford & Blackmore's Price Action Trading Course". The purpose of this material is to dramatically improve the technical analysis and trading methods of whoever reads it.

First, a disappointment:

Many of the 'trading systems' available for purchase today make many a promise to 'supercharge your trading, and bring in THOUSANDS of pips a day!!!'

This trading style… is not one of those. We consider material of that nature to constitute a 'scam'. We are not going to make ridiculous false claims like that. We take a more 'investment-minded' approach to speculation in the markets. We look for obvious patterns that occur over larger time periods, to both decrease our market participation (to minimize risk), and maximize profits by taking part in long-term trends and swings.

Why the larger timeframes?

We believe that technical analysis, whether it is forex, or stocks, or commodity futures, is a form of statistical analysis. That is, price is moved up and down the charts in accordance with the buying and selling behaviour of the market participants. So when you look at a price chart, you're really looking at a 'map' of the general market's belief of the value of whatever it is you're trading. Now, with that being said, anybody who looks at statistics can tell you that the larger the sample size you use, the more accurate the information. When you look at a five-minute candle, you are observing the behaviour of whoever bought or sold within that five-minute period. If you look at a Daily candle, you are seeing the behaviour of whoever bought or sold within an entire twenty-four hour period. Now, of the two, which one sounds like it is more likely to give you a 'true' representation of where the market is heading?

Lastly, a pick-me-up:

Our approach to trading provides a framework upon which your trading style can be improved in order to successfully trade as a career. The methods we teach and the principles we outline are the same main tactics used by career investors and speculators in order to accumulate wealth over the course of your lifetime. While our trading methods will not turn you into an 'overnight millionaire', it will easily generate safe, reliable, and dependable returns that will enable you to achieve your dreams and goals. The old adage is, "Rome wasn't built in a day". We take the same approach to money management. With this material, you will be able to generate returns that will easily surpass the majority of your peers, and push you ever further into the realm of profitability.

In closing, we hope this material achieves everything we think it is capable of, and help turn you into the trader you want to be. If you have any trouble with the information, or have any questions whatsoever, don't hesitate to contact us. We are here to help you in any way we can.

Disclaimer - CFTC RULE 4.41

IMPORTANT - Trading foreign exchange on margin carries a high level of risk, and may not be suitable for all investors. The high degree of leverage can work against you as well as for you. Before deciding to invest in foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. The possibility exists that you could sustain a loss of some or all of your initial investment and therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with foreign exchange trading, and seek advice from an independent financial advisor if you have any doubts.

Clearly understand this: Information contained in this product is not an invitation to trade any specific investments. Trading requires risking money in pursuit of future gain. That is your decision. Do not risk any money you cannot afford to lose. This document does not take into account your own respective financial and personal circumstances. It is intended for educational purposes only and NOT as individual investment advice. Do not act on this without advice from a certified investment professional, who will verify what is suitable for your particular needs & circumstances. Failure to seek professional advice prior to acting could lead to you acting contrary to your own best interests & could lead to losses of capital.

CFTC RULE 4.41 - HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER-OR-OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN.

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About This Course

What you need to know before you start?

This course is designed for people who already have a very very basic understanding of how Forex works. You do need to know the simple stuff; what a pip is, understanding the different types of orders, and what support and resistance is for example, just the entry level basics.

If you are so new to Forex and you haven't learned the basic concepts yet, don't worry. The Baby Pips 'School Of Pipsology' explains everything you need to know in a way that is simple to understand. Once you know all the basics, you can come back to this course and we can teach you all the cool stuff.

http://www.babypips.com/school/

www.ForexWinners.net

What you can expect to learn from our Price Action course

We're going to teach you how to trade simple, easy-to-understand setups, which require very little of your time in front of the charts. No need to stare at the screen and monitor the markets for hours on end; you can set your levels and walk away. No need to use complicated indicators, all you need is a price chart. No need for any special charting software, you can use any charting software that you like.

This course covers six simple, powerful Price Action setups, which will show you how to trade the bounces and breakouts! These setups will be able to get you in on the moves before they happen. You will be shown how to tweak entry points & stop losses so that you can increase the return of your trades greatly!

You will learn money management techniques that will allow you to make money even if you're losing over ½ of your trades! And also be shown the bad thinking habits that will destroy your trading, and how to avoid them.

After mastering the content in this course, you will see the markets like you never have before and be able to enter positions will full confidence!

Charts

The beautiful thing about price action is that you are able to trade off of simple price charts, free from any clutter from indicators. I operate exclusively off the **Daily** chart, and only using a broker whose Daily candle closes when the **New York Market Closes (GMT 22:00)**.

Why New York Close candles?

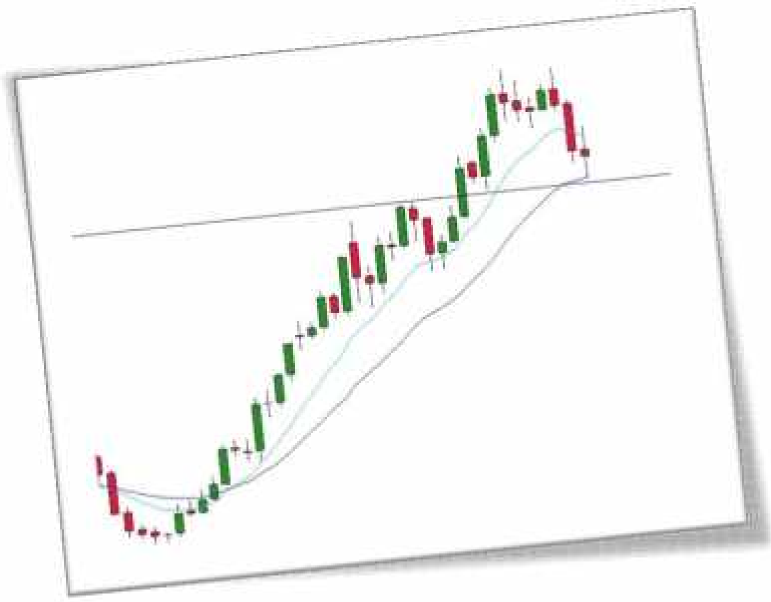
These **New York Close (NYC) candles** give 1 true 24-hour session's worth of data. NYC candles open when Sydney markets open at the beginning of the week, and close when New York Closes. So one daily candle is a true representation of what happened during that entire session. This gives 5 daily bars per week, with no weekend/Sunday candles. You can still trade through whatever broker you like, the important thing is to make all of your trading decisions based on analysis of NYC candles. I personally have a New York Close broker terminal open for charting, and then I switch over to my main broker's terminal for placing orders. Easy!

Some examples of New York Close brokers are:

- FXDD
- FX OPEN
- ALPARI UK

Chart Setup

Daily Charts and above…



For the Daily charts and above (Weekly & Monthly), we have the plain candlestick chart with 2 Exponential Moving Averages (EMA) added.

- An EMA set to **10** as a 'fast EMA'
- A slow EMA set to **20** as a 'slow EMA'

For the traders who prefer to use the lower timeframes (TFs)…

If you're using anything lower than the Daily chart, then you simply need the plain candlestick chart loaded as shown to the right.

I rarely trade off lower timeframes myself; occasionally I will look at the 4 hour charts if market conditions are right and the signal is excellent. You will find that signals generated on the lower timeframes usually manifest themselves on the daily chart anyway. Also, when using lower timeframes, the rate of 'whipsaws' or false signals increases dramatically. Trading our specific methodology on any TF lower than the Daily may work sometimes, but more often than not you will likely find yourself overtrading, and entering on setups that don't hold much value as a signal.

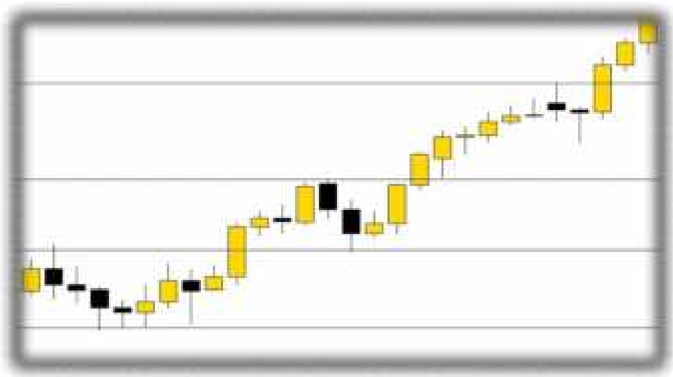
Support & Resistance

Marking out correct support and resistance (S&R) lines will be crucial to trading the setups shown in this course. The reason for this is simple; trade signals that occur when price is reacting to significant S&R levels have a much higher success rate than signals that occur 'in the middle of nowhere'. Therefore, we will only mark out S&R lines that are the most **significant**.

I mark most of my S&R off the daily chart, but occasionally will use the weekly and even the monthly chart as an added tool to mark out the important areas. Naturally, S&R from weekly and monthly charts have a lot of weight added to them, and definitely should have your attention when price approaches these levels.

Notice how I said I only mark the levels on my chart from the daily, weekly and sometimes monthly. Intraday levels on the 1 hour chart and below do not interest me at all, if a support or resistance level is important enough to be worth nothing, it will show itself on the daily time frame at least.

If you sit there marking out all the intraday levels that you see your chart is going to be loaded up with lines everywhere and it will be hard to make sense of it all.

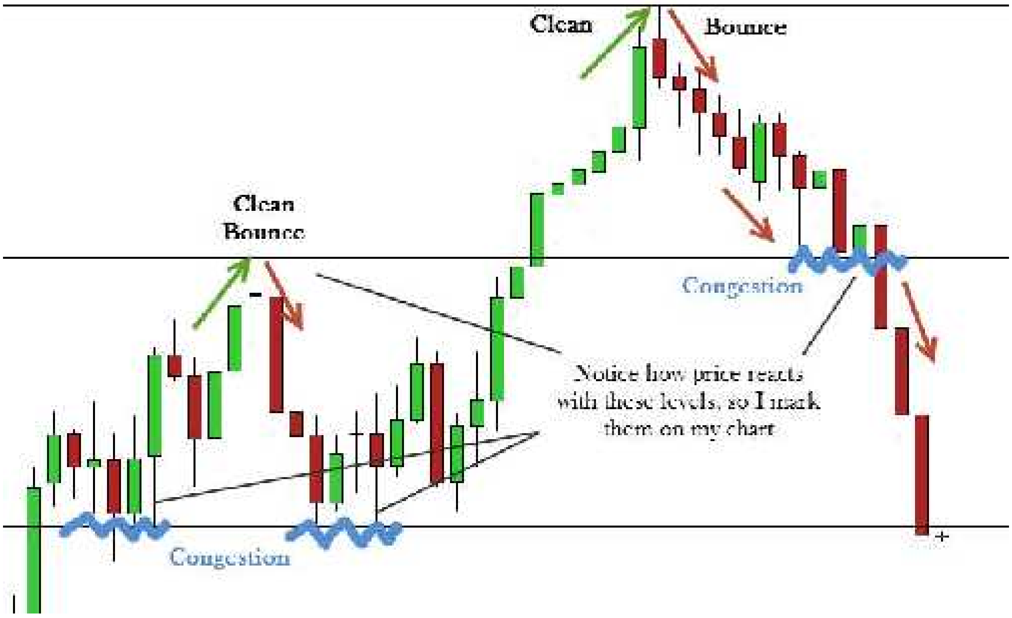


Now look at the chart to the left. This is a Daily Gold chart from 2011, when the market was '**Trending**' perfectly. Notice how I've only marked out the important levels. Just looking at this chart alone, there were several chances here to buy into this trend using entry methods from this course ☺.

If your chart looks something like the above chart, you're over doing it! Sure they all may be valid S/R lines, but we only need to plot the ones that price is currently reacting with. Zoom out on your chart a little so you can see a month or two worth of price action, plot the levels that price has been reacting with in that that period, this way you are working with the current markets interest in S/R.

Support & Resistance

In the chart below, I have marked 3 S/R lines which price has been reacting with in recent times. Don't waste your time zooming out and marking all the lines, just mark the ones around the current price movement. So the next resistance or support levels around the current price value.



Now, when plotting the S/R lines, I am looking for the levels which act as a turning point (a price bounce) or where price congested (congesting on top of support, or congesting under resistance).

The chart above demonstrates this, there are sometimes clean bounces off the the S/R levels which act as a turning point. Or there is built up congestions on top or below the levels, showing the supportive or resistive properties.

The thing you have to remember is the markets interest in S/R levels change all the time, so as time goes on you must adapt to the market conditions and keep plotting the major levels price is reacting to. Don't get stuck with the mindset support and resistance levels are set and forget, no you have to keep up with what is going on in the market. Obviously this is a slow process, so you won't have to update all your levels on a daily basis or anything.

If you insist on using the lower timeframes, still stick to using the Daily support levels, the chart to the left shows a 4 hour chart but with the Daily S/R marked out on it. Even though we are still working on a low timeframe, we are still using strong, significant S/R levels from the higher time frames which will improve our chances with intraday trading.

Support & Resistance

Plotting support and resistance is not exact maths or science, it leans more toward being an art, which you get better with over time. Plotting the levels is sometimes plain easy, other times it can be a lot harder, depending on the market conditions at the time.

Support and resistance might also be more like a support area or resistance area, instead of a solid key level. This happens a lot in ranging markets, which we will show later on. But generally when mapping out support and resistance in ranging markets, we are only interested in the upper and lower boundaries of the range, anything in between is usually discarded.

In the above chart, we can see the market went into ranging conditions, which means it started bouncing between two major levels, so it is the upper and lower level that contain the range we plot on the chart because we are looking for signals that form off the upper resistance or lower support containment.

← This market is just one huge mess. The situation is volatile and unstable, with no clear, concise S&R areas to be marked out. When you see these conditions, it's best to just move along to the next chart. Trying to trade these types of market conditions is very risky.

Trending Markets

So what is a trending market?

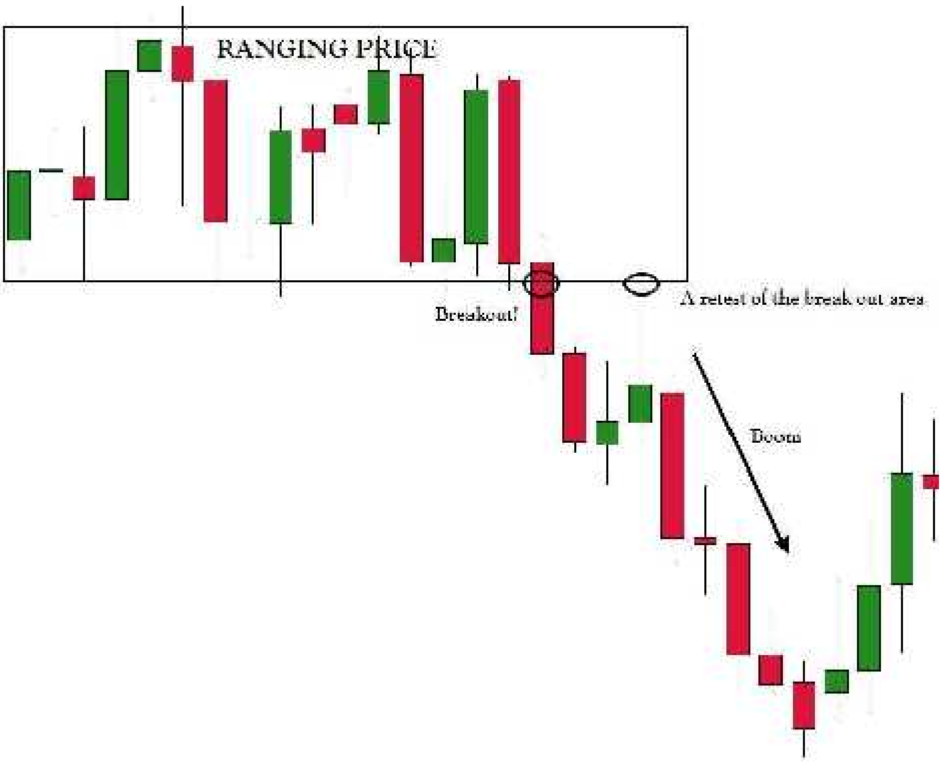
A trending market is simply a market that is consistently making Higher Lows (HLs) and Higher Highs (HHs), **or** a market that is doing the inverse – moving down and making Lower Highs (LHs) and Lower Lows (LLs). See below how the Dow Jones was in a nice bullish uptrend.

As you can see, the best time to enter a bull market is when it dips down and forms a higher low. This is called a ‘pullback’, or **retracement**, and it is here we look for signals to go long. The inverse is true for bearish trending markets, look for sell signals at lower highs. The chart below is a nice bear market on the USD/JPY

Ranging Markets

A ranging market is where price is bouncing between 2 major support and resistance levels. The support and resistance levels are not usually an exact value, but are typically more like two separate areas: a support area, and a resistance area. These 'areas' could also be referred to as 'zones'

Ranging markets are great to take **buy signals off the Support zone,** and **sell signals off the Resistance zone**, but eventually the range will break. When the market finally breaks out of its range, the move tends to be explosive in nature. If you are not correctly positioned, or are not in a trade on the break out, don't worry. The market tends to pull back and retest the breakout area (Top or bottom of the range). This area is also an excellent area to take signals from.

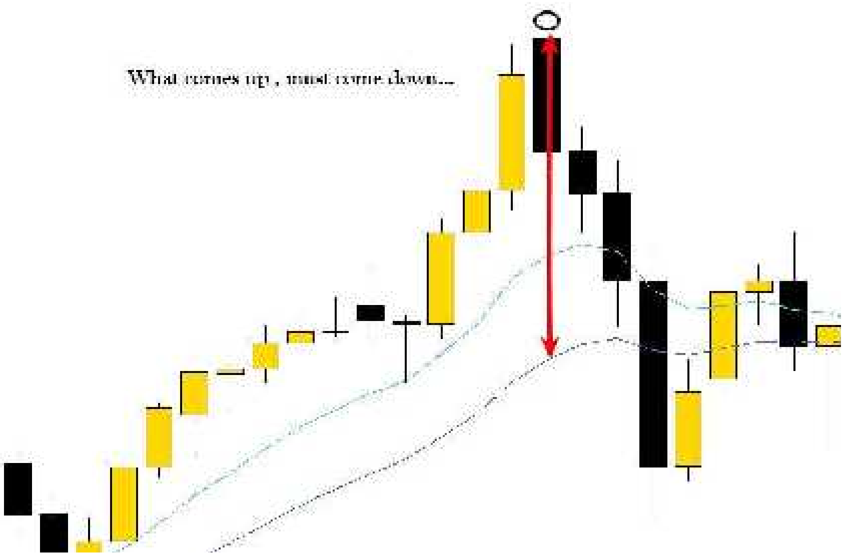


Dynamic Support & Resistance

The word 'dynamic' is defined as 'a system characterized by constant change or activity'; The 2 EMA's that we place on the Daily chart and above are used for dynamic support and resistance, because the EMA values change to reflect the activity of price. Price tends to stick close to the EMA values. Think of the EMAs as 'magnets' which price is attracted to. Occasionally price does get the momentum behind it to move great distances from the EMAs, but the further price gets away from them, the stronger the attraction gets between the two, and price gets pulled back in.

← As you can see here on the EURUSD, when the pair was in an uptrend in 2011, price never got too far away from the EMA values before getting pulled back to the EMA area (a correctional move). Also notice how price finds support here. The 20 day EMA acts as much stronger support than the 10 day EMA, and it is here that we look for trade signals.

On the Gold chart to the right, we can see how price has exploded up, accelerating away from the EMA value. But look what happened immediately after: price crashed back down towards the dynamic support, and in this case, crashed right through them.



Dynamic Support & Resistance

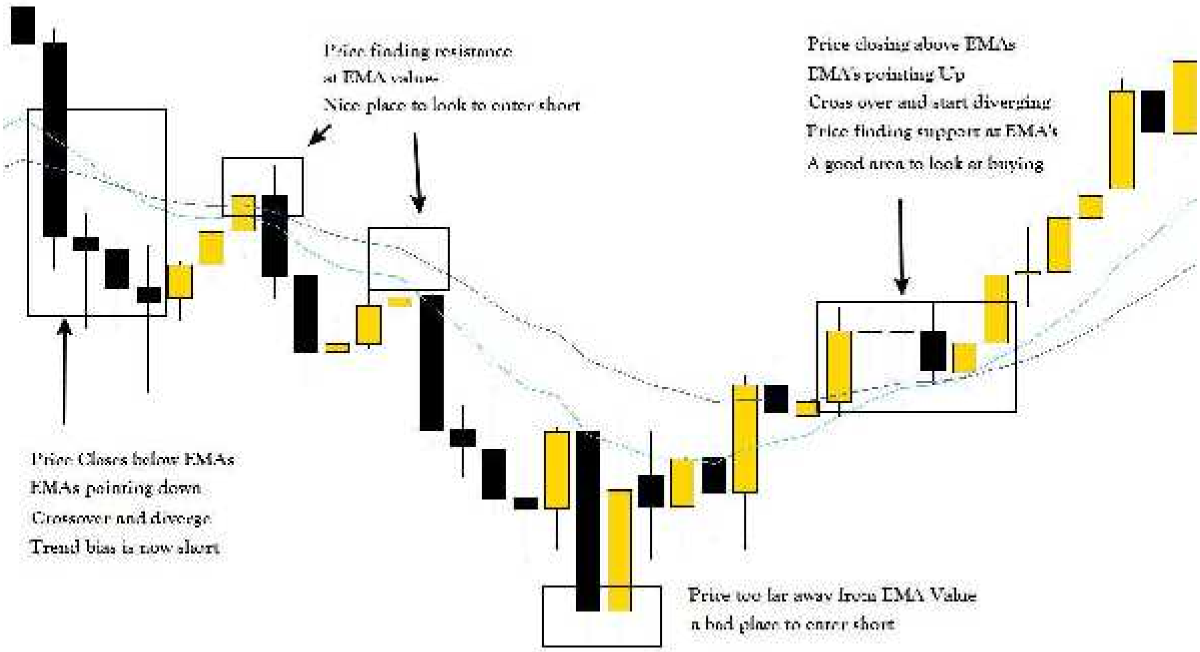
So what else are the EMAs good for? Well, we can look at the divergence between the fast EMA and the slow EMA. When they are diverging (moving further apart), this indicates that the trend is building strength. If they start contracting, this may indicate the trend is losing steam, or coming to an end, which means the market may start to get choppy, start ranging, or might just be going through a deep correctional retracement after a long move. Check the **weekly chart** and where price currently is in respect to the **weekly 10/20 EMAs**. This may help give clues to where the Daily chart is heading, because price respects the EMAs on the weekly chart just as they do on the Daily chart.

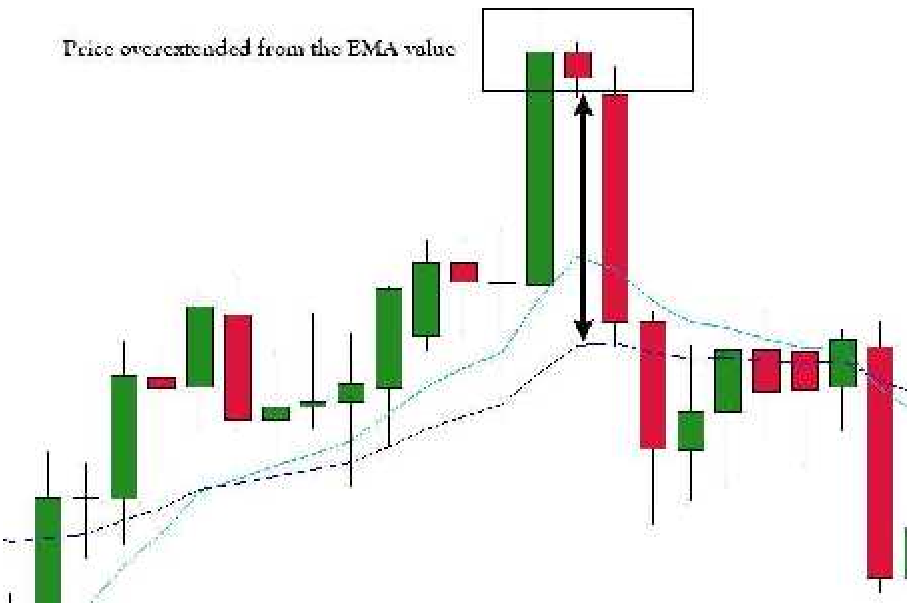
← Just before this AUD/JPY trend took off you could see building bullish pressure in the EMAs. Also notice when the trend started to take place, price was respecting the dynamic support value of the EMA's.

Another important feature, which is often overlooked, is which side of the 20 day EMA price is closing on. If price is closing under the 20 day EMA and the 10 day EMA is diverging lower from the 20 day EMA, then really we are only looking to short the market (vice versa for bullish markets). Also remember that we don't want to enter a position if price is too far away from the EMA value, because we know the risk of a retrace back to the EMAs is very high. **The trend is your friend**; if you always play your cards in the direction of the trend you have a higher chance of success. Let the EMAs guide you in trending markets.

Dynamic Support & Resistance

A look at how EMA's help analyze this gold market.



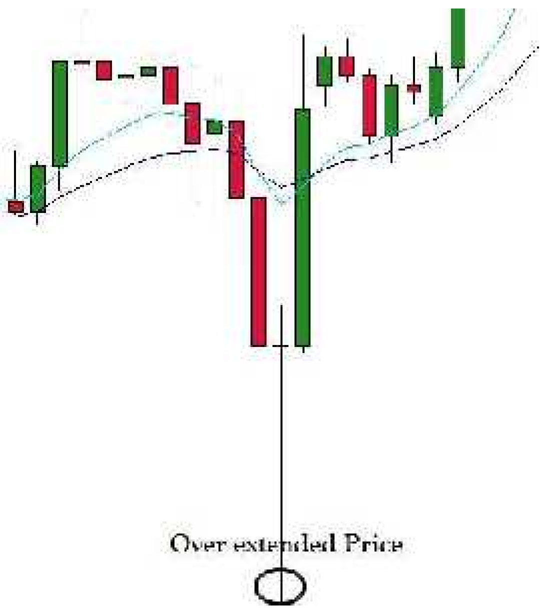


← So here we have the EURUSD which has aggressively accelerated up and become very over extended from its EMA value. Price is now at an extreme level, and the 'magnetic attraction' between price and the EMAs is now extremely high. Remember, the further price moves away from the EMAs, the stronger the attraction becomes between them. An advanced technique is to use this extreme attraction to our advantage, because we know there is a high chance of a correctional move back to EMAs. There are often opportunities that we can take advantage of where we are able to catch this move back to the EMAs. In this case there was an Inside bar signal we could have capitalized on.

Dynamic Support & Resistance

← You can see in this ranging market, the EMA's do not get respected as dynamic support or resistance. EMA's are **only used as dynamic support or resistance in trending markets.** However, the overextended rule still applies to all market conditions.

2 more example below of price accelerating too far away from the EMA value.



To summarize:

- We know that EMAs act as moving (dynamic) support and resistance in **trending markets**.
- We know it's best to enter the market when setups form close to the EMA's
- We know to trade with the direction of the EMAs(The trend is our friend)
- We know to take note of what side of the 20 day EMA price is closing on. This helps us determine the market bias.
- We know if price accelerates away from the EMA values rapidly, there is a high chance of a correctional move back to them that we can often take advantage of.

Trend Lines

I don't use trend lines unless they are very significant in nature. When there is an obvious major trend line, I will plot it on my chart and use it to help add weight to any setups that may form off it. But I must admit, I do not use them very much.

Below is the gold chart with a massive trend line on Weekly candles.

Above is a nice trend line off the Daily EURUSD chart.

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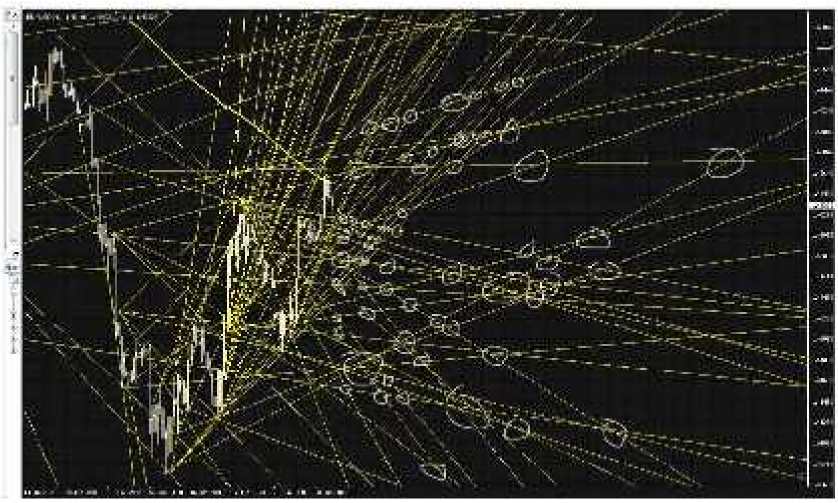
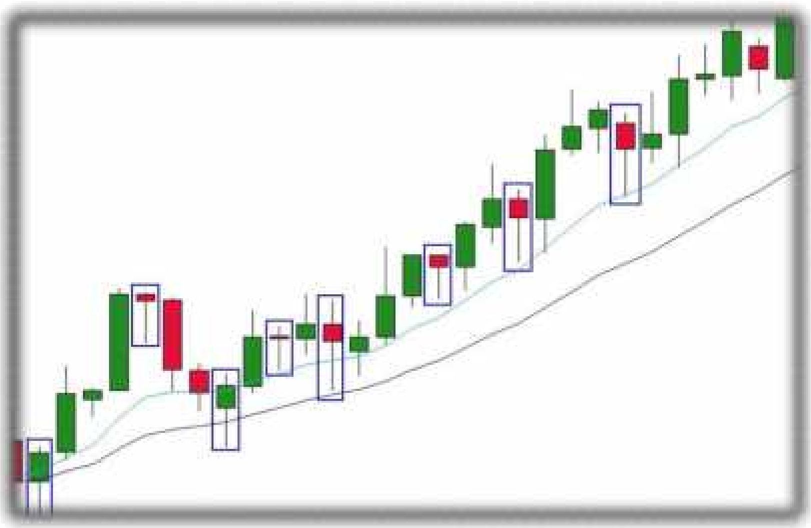


The above pic is chart from another trader's screen that they were kind enough to share with me, as you can see this trader has really over done it with trend lines, causing the chart to be confusing and untradeable.

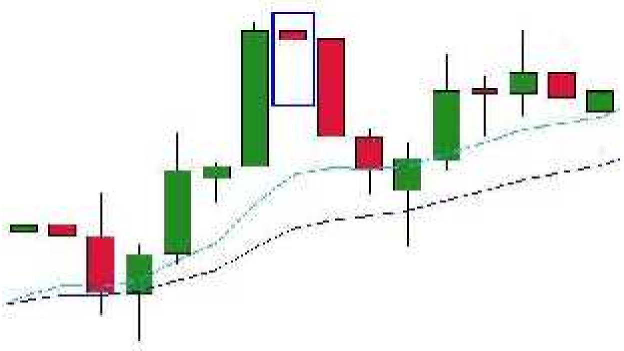
The Rejection Candle

The first trade setup is the **Rejection Candle**. It is also known as the Pinocchio Bar, shooting star, and hammer candlestick patterns. A rejection candle is basically a candle that has moved either up or down to an area, been rejected by the market, and closed with a long tail (or 'wick') on it. A candle with a **long lower tail is a bullish indicator,** and a candle with a **long upper tail is a bearish indicator**. These types of candles are common, but not all of them are signals. Location on the chart is everything. To qualify these candles as setups, we must first look at other factors before considering a position in the market.

Rejection candles help us determine **reversal** points in the market. They are good indicators of whether price is respecting S&R or the EMAs in trending conditions, or even trend lines themselves. Be cautious when trading rejection candles that are small in size, as they hold little to no value as a signal. The best rejection candle signals form in established trends, showing rejection off the EMA area.



The above chart is the AUD/USD on a strong uptrend. We can see the EMAs are diverging, and are being respected by price. All the candles that have been marked with a blue box are rejection candles. There were several opportunities here to get in on this trend. There were also some rejection candles that would have got you stopped out. Why? Because their location was not ideal.

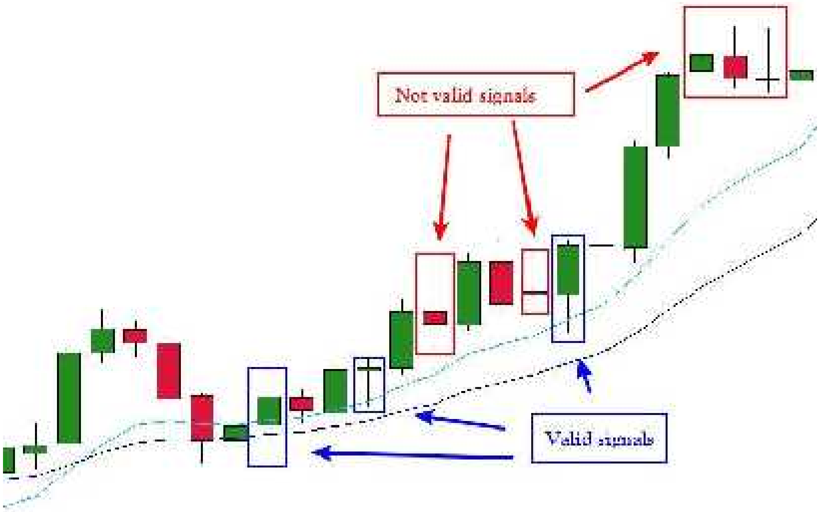


← Let's have a look at the second rejection candle marked in the previous chart. We can already see that this is a bad area to go long from, because price has already accelerated away from the EMAs, and we already know that when this happens, the chance of a retracement back to the EMA value is very high. That is exactly what happened here.

The Rejection Candle

So when looking to trade rejection candles, you must focus on the area the candle is rejecting from. Some areas of interest are...

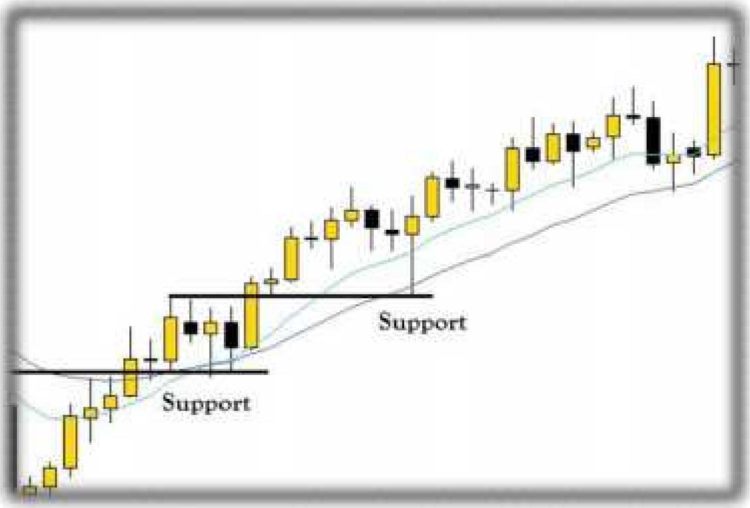
- Strong support or resistance areas
- EMA Values in **trending markets**
- Major Trend lines



← In this GBP/JPY chart we would have only been looking for long signals because the trend is bullish. We only want to trade rejection candles with lower tails (bullish signal) and we want to make sure they are rejecting an area of significance. All the rejection candles marked in blue here are rejecting the EMA values. Which hints to us that price has found support here.

Here on the EUR/AUD chart we have a clear down trend. We can see the rejection candles with upper tails (bearish signal) that have rejected the EMA value were ideal places to short this market. These bearish rejection bars are showing us that price is respecting dynamic resistance, which is a good indicator the trend is going to continue.

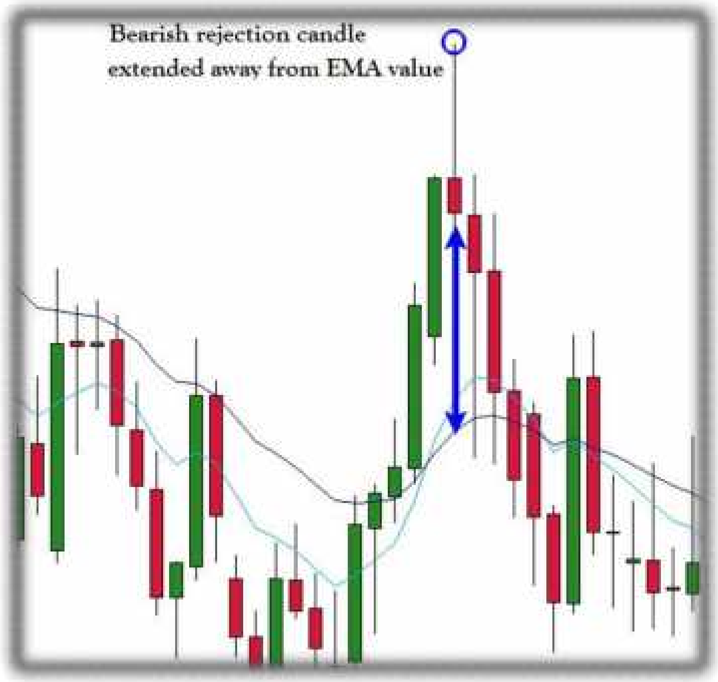
Now let's look at rejection candles interacting with support and resistance areas.



← To the left we are looking at a gold daily chart. Notice there are 2 bullish rejection bars reacting with support in an uptrend. Not only are they rejecting support, they are rejecting the EMA values as well. Now there are 2 areas of interest that these setups are reacting with, which gives them a higher chance of success.

In ranging markets, we are looking for rejection candles at the top or bottom of the range. This market dropped 3 bearish rejection candles off the top of the range.

← See why these rejection candles are not signals. This choppy market provides no clear trend, and no real key support or resistance levels to trade from. This is why the candles alone are not a good enough reason to enter the market.

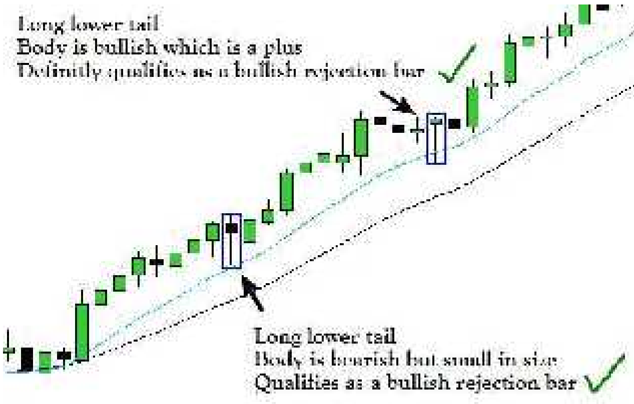


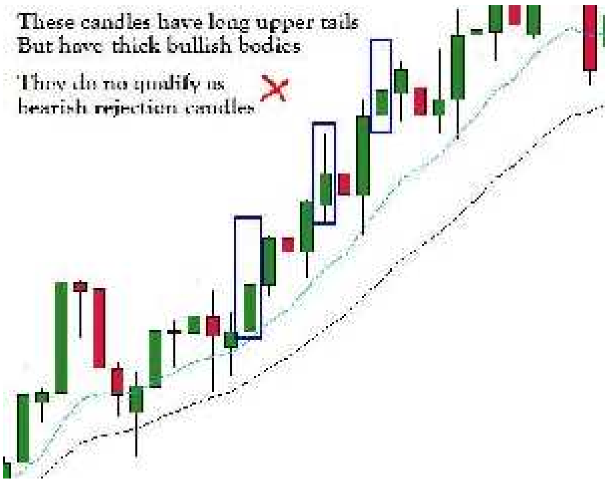
← Remember when price accelerates too fast away from its EMA value and causes a correctional move back to them? This bearish rejection candle was a good chance to take advantage of that situation.

Below, we have EURUSD in a clear downtrend. The 3 marked candles are rejecting the EMA values and resistance levels. A nice cocktail of confluence to add strength to each trade.

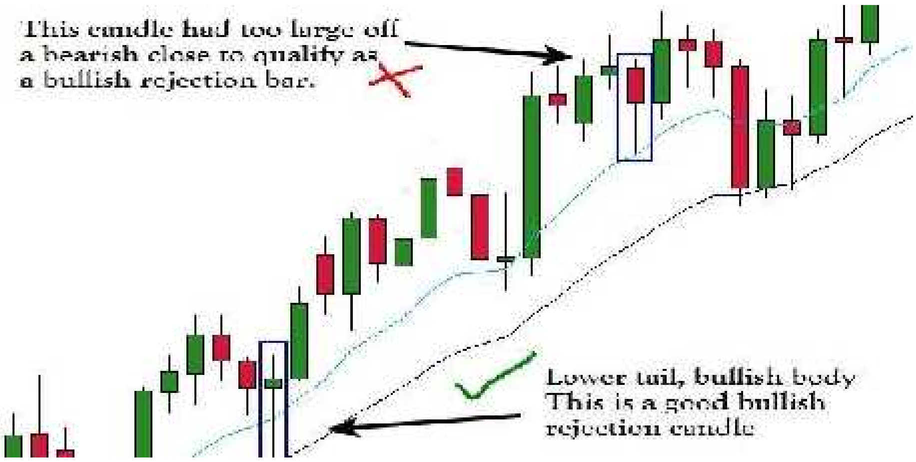
The Rejection Candle

One other factor that should be pointed out is the body of the rejection candle itself. If a candle forms with a lower tail and noticeably bearish body, then it's not really a bullish rejection candle. However, if the body is only slightly bearish, and there is a long lower tail, then this can qualify as a bullish rejection bar. Also if there is a lower tail and the body is chunky but bullish, this can qualify as a bullish rejection bar too. Essentially, the wick or shade of the candle must be convincingly larger than the body of the candle, unless the candle closes in the same direction as the rejection.



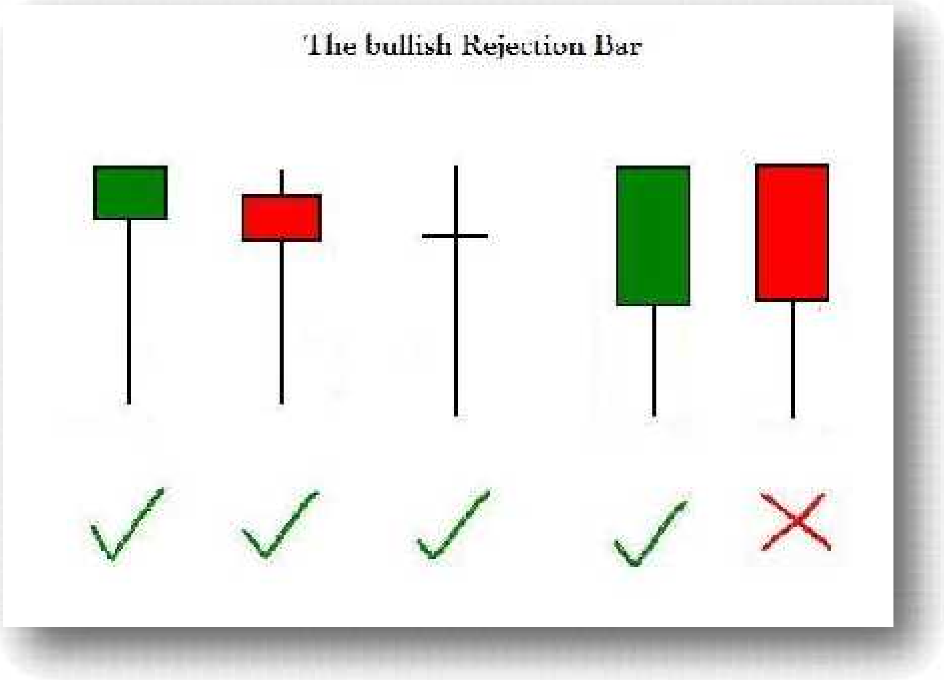


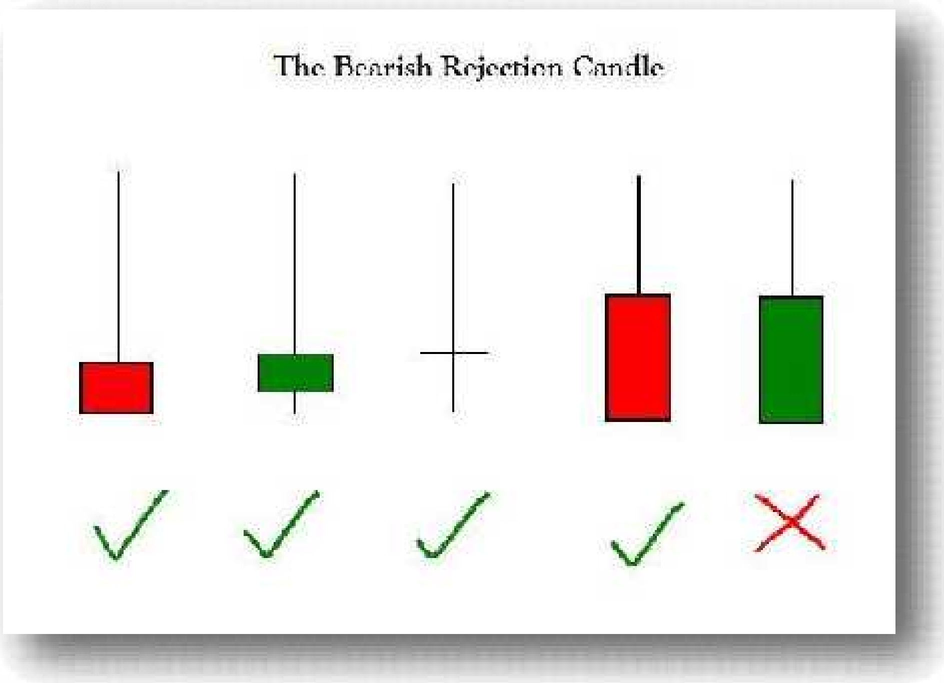
← See how these candles do not represent rejection candles. They have a tail, but the body colour is all wrong. If these candles had closed bearish, then they would have qualified as bearish rejection candles (But not short signals). Each candle tells a story; these candles do not tell the story of bearish rejection with such a bullish close.



The Rejection Candle

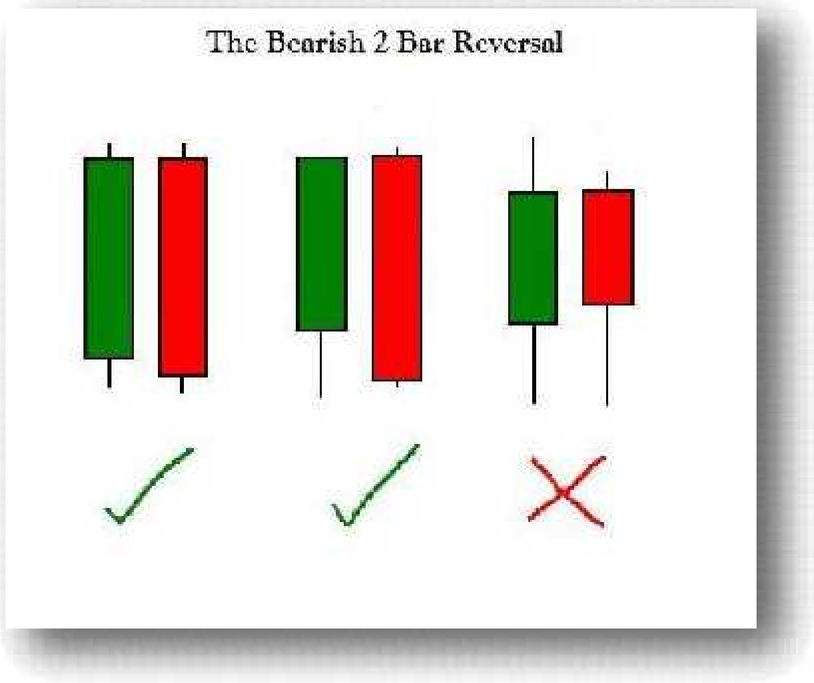
Finally, let's look at some visual examples of qualifying rejection candles.

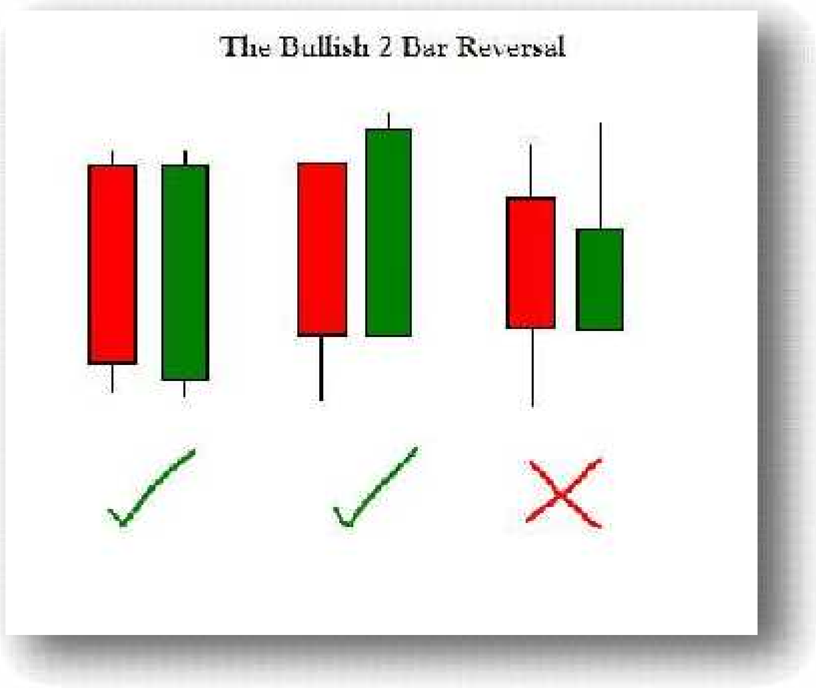




The 2 Bar Reversal

The 2 bar reversal setup is ultimately the same thing as the rejection candle setup in principle, the only difference being two bars make up the signal instead of a single candle. Rejection candles show that price moved to an area on the chart, and then was rejected by the market and closed back down near its open, leaving a tail on the candle. With the 2 bar reversal, the first bar moves into an area on the chart, closes, then the second bar opens and moves back in the opposite direction, closing near or past the open of the first bar.





The 2 Bar Reversal

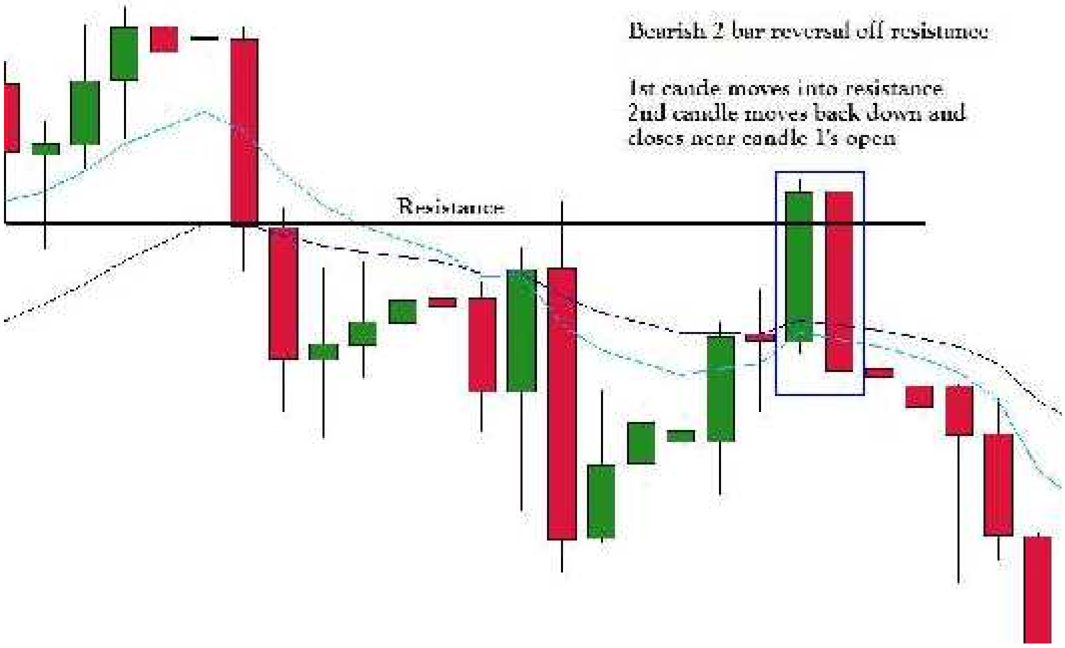
2 bar reversals are not as common as rejection bars, but can still offer good trading opportunities when they form. Just like the rejection bar setup, 2 bar reversals must be large in size. The bodies of both candles must be large, with no large tails sticking out of either end of the candle. Small 2 bar reversal setups are not signals; they must have a large volume, and have good formation.

To the left we have an uptrend on the EURUSD; the two blue boxes are highlighting **bullish 2 bar reversal** setups. The first candle moves down, the next candle moves straight back up which displays bullish rejection.

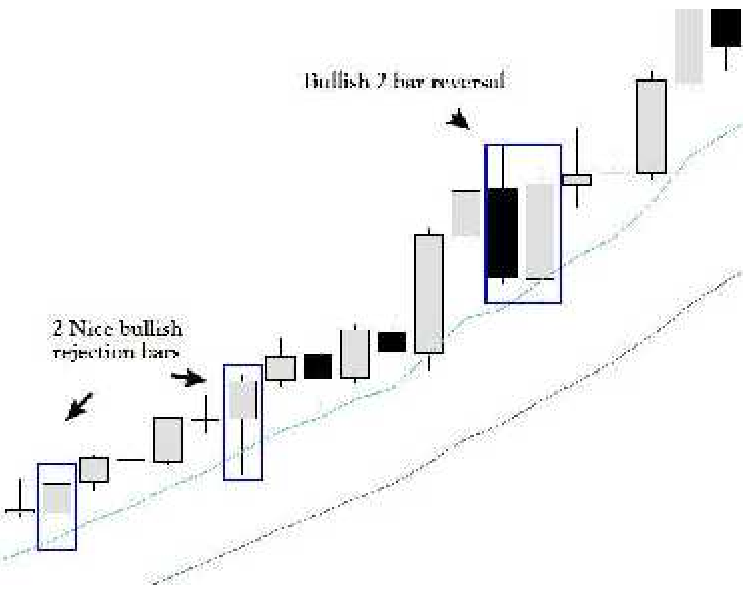
← This example shows how a rejection bar and a 2 bar reversal are identical in theory. First, we have a bearish rejection candle rejecting resistance, then we have a 2 bar reversal rejecting resistance. Both setups are the same in nature, since it was the same market dynamics that created both setups.

Because the 2 bar reversal and rejection candle are identical in nature, they are traded in the same way. For the 2 bar reversal to be a valid signal, it must be rejecting an area of significance, a major S&R level, EMA Value or Trend line etc. Just remember that the second bar must close near the first bars open and there shouldn't be any long tails sticking out of any of the candles.

The 2 Bar Reversal



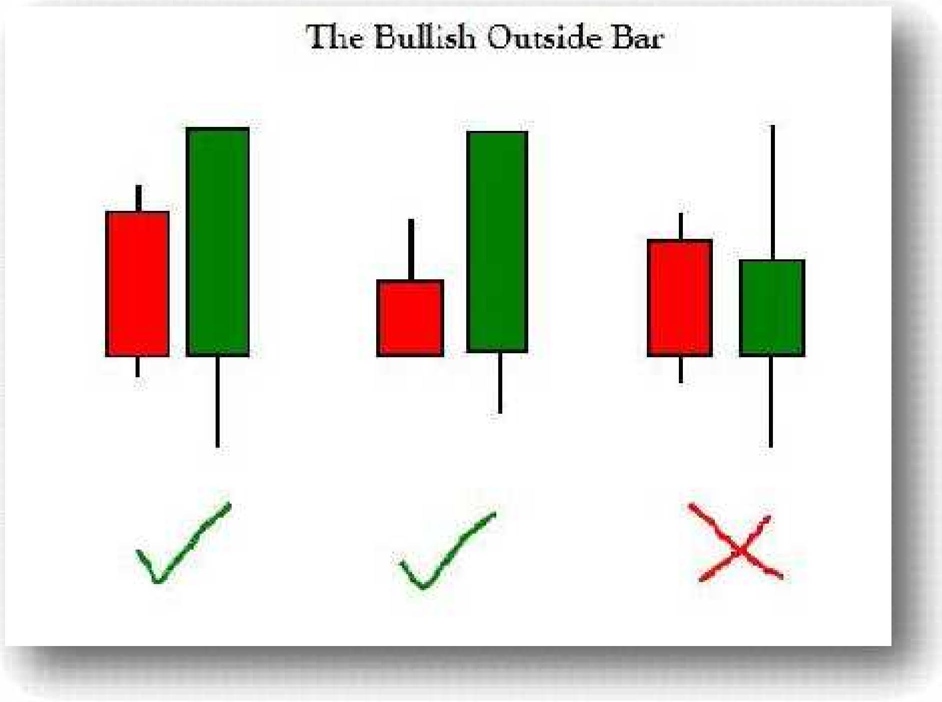
This bullish 2 bar reversal was against the trend. Remember, **the trend is your friend**; going against the trend will get you burned.

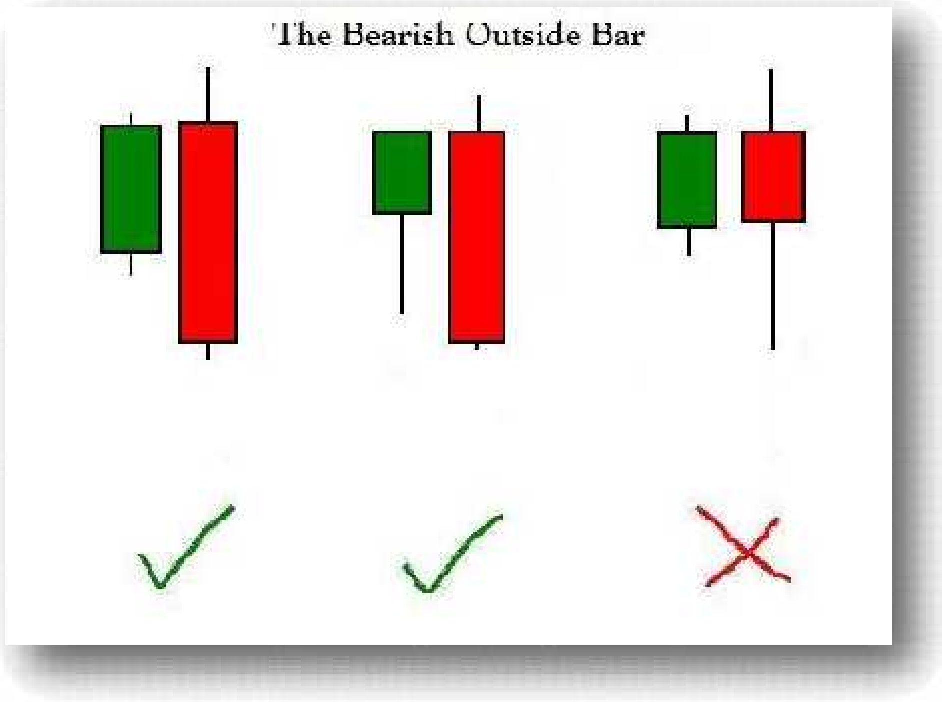


← In this uptrending silver market, there were two nice bullish rejection signals and then further along a bullish 2 bar reversal. All 3 setups would have gotten you in on the trend.

The Outside Bar

The outside bar is also known as the 'engulfing candle'. The outside bar setup is a two candle setup. The first candle closes in one direction, then the next candle opens, and quickly reverses, shooting off in the **opposite direction** of the previous candle, forming an outside bar. To put it simply, an outside bar is a candle whose high value is higher, and low value is lower, than the previous candle. A Bullish outside bar close must be higher than the previous bar's open, a bearish outside bar close should be lower than the previous bar's open, and outside bar should not have any large tails protruding out of its body.





← A bullish outside bar setup on gold. The first candle had a bearish close; the second candle opened and continued the bearish movement, broke the first candles low, and shortly thereafter reversed up in the opposite direction, causing a **false break** of the low of the first candle. Then price continued up and **closed higher than the first candle's open.**

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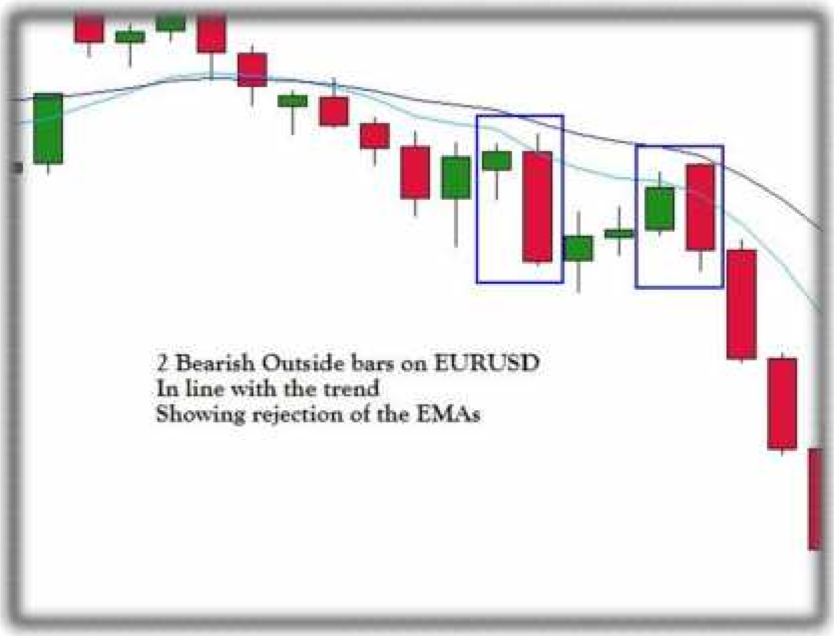
The chart to the right shows two bearish outside bars that formed in a downtrend. Notice how the outside bar first causes a false break of the first candles high, then reverses quickly back in the direction of the trend. Just like rejection candles and 2 bar reversals, outside bars that show rejection of an area of interest like the EMAs qualify as signals.



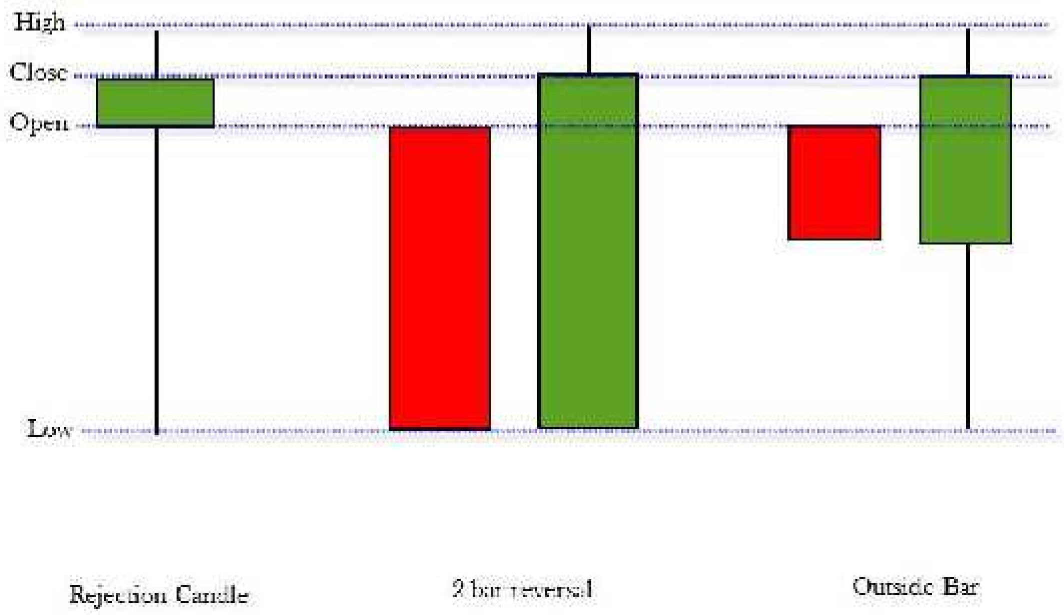
The Outside Bar

This chart shows a clearly defined bullish outside bar. When the second candle opened, it broke the lows of the first candle, causing a false break, then reversed and closed aggressively higher in the opposite direction. Like rejection candles & 2 bar reversal setups, outside bars are only valid signals when reacting with important areas marked on your chart, for example: **major support and resistance levels, the EMAs, range tops and bottoms, swing highs or lows, and significant trend lines**.

Rejection candles, 2 bar reversals & outside bars form often enough. All the examples shown are from the Daily charts. The lower timeframes are littered with these setups, but that doesn't mean they are going to work as well as the signals that form on the daily chart. The quality of the setups degrades rapidly as you move down through the lower timeframes. It is highly recommended that you base all of your trades off the Daily chart for accuracy. Even if you are taking a trade off the 4 hour chart, make sure the Daily chart agrees with what you are doing. Going against the Daily will sting you where it hurts.

Comparing The 3 Rejection Setups

We have now talked about the Rejection candle, 2 Bar Reversal and the Outside bar. You might have picked up on this as you were reading through, when you really think about it, and place the setups side by side, you discover that all three setups are all very much the same thing, each one is just being viewed from a different perspective in time. The illustration below will visually show you how the three setups are closely related.

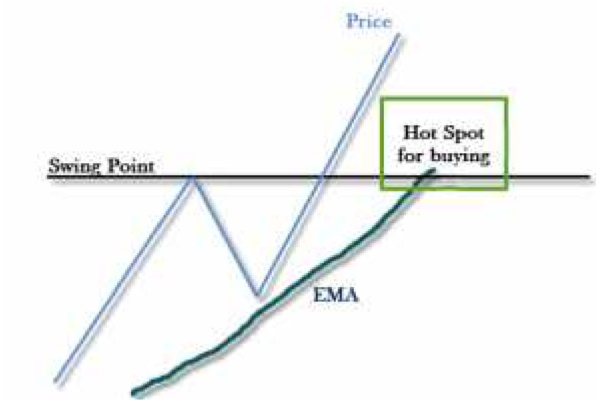


All three of these setups are price reversal patterns, all three tell us the story of price moving down to an area on the chart, being rejected by the market and forced back up in the opposite direction.

We need watch out for these signals forming at areas of the chart where we anticipated price was going to bounce and reverse. These are what I call the hot spots on the chart, where 2 or more things line up together to create a zone or area to either buy or to sell in, depending on whether they are a hot spot for longs, or a hot spot for shorting.

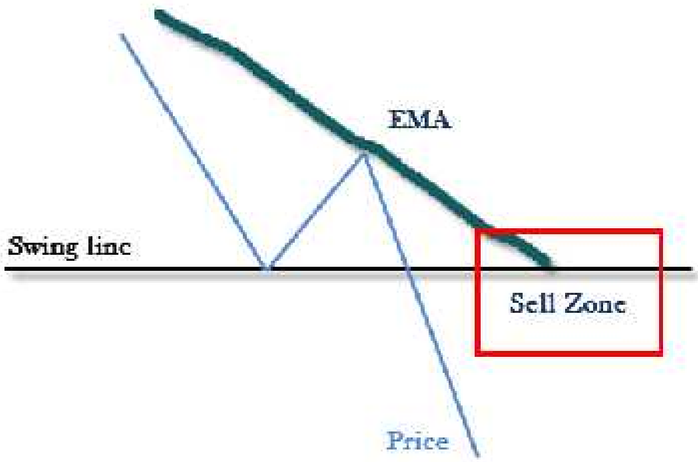
The Hot Spots

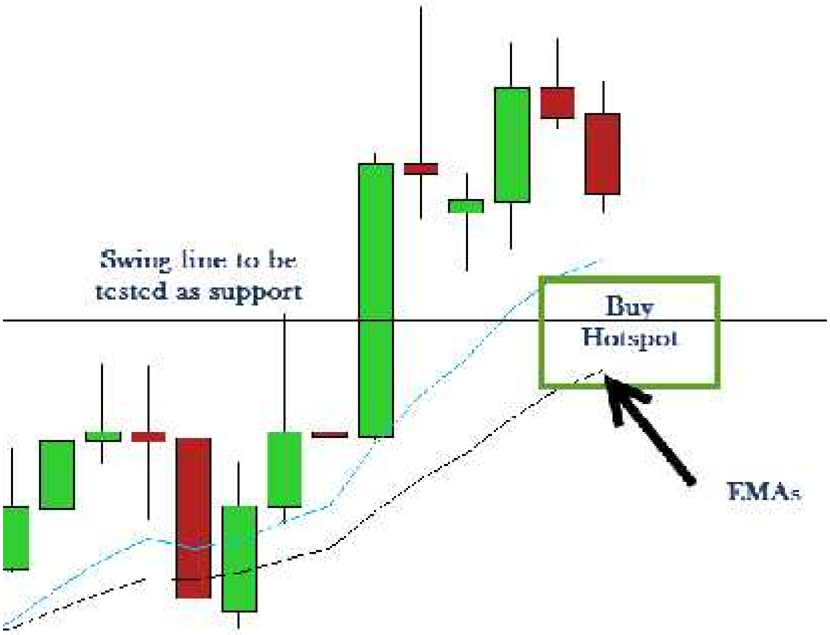
There are areas or zones, that present themselves on the charts which I like to refer to as 'Hot Spots', these hot spots are basically the areas/zones on the chart where a number of things will line up together to produce a high probability low risk place to take your trades from. The hot spot is either going to be buying hotspot long trades or a selling hot spot for short trades, depending on the chart situation at the time. Below is a basic example of a hotspot for long signals.



The above example shows a situation which would produce a hot spot for long signals. Price has broken out of a resistance level in an up trending market, now looking overextended, we are watching for a retrace to the hot spot, anticipating a long signal to form here so we can jump in on the trend. The reason this is identified as a hot spot is because there are 2 or more factors lining up that will boost the value of any bullish signal that forms in this area of the chart. We have a swing line waiting here to best tested as support and in the same area we have the (EMAs) waiting to be tested as dynamic resistance, not to mention there is an established uptrend so we are only looking for long trade to trade in line with the trend / momentum.

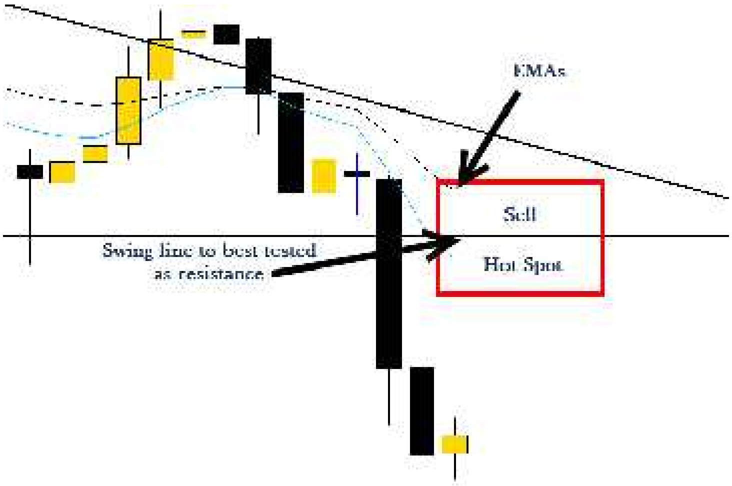
Obviously this will be the inverse for down trending markets, the selling hot spots will appear when resistance lines are in the same area of the EMA's in a bearish market. This is the environment we want to see a short signal form in.

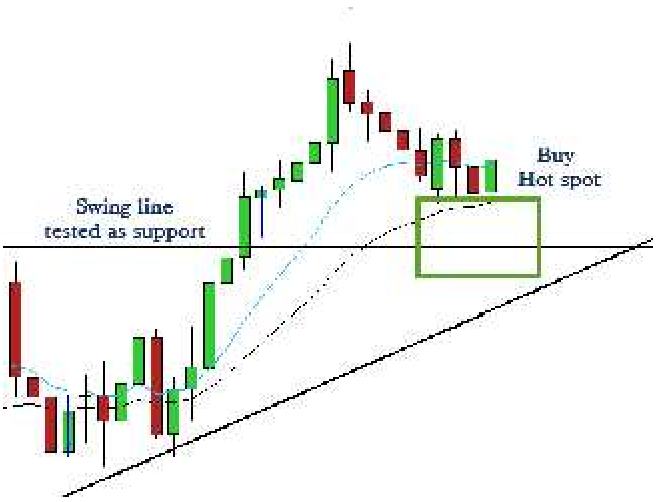




← The chart to the left shows a live example of a hotspot on the chart hot for buying. Price has broken out of a resistance line in a bullish trend. Now we are waiting for price to retrace to the area where the EMAs and the level waiting to be tested as support to meet. When price reaches this area all we need to then is a bullish signal to tell us to go long.

The live gold chart to the right is pointing out a hotspot for a short trade to form. See how the EMAs and the swing point meet together in the hotspot area? This is creating a potential turning point for the market, because the overall market momentum is down, all we need now is one of the candlestick short signals form in this hot spot for that extra confirmation to sell.





← The live GBPUSD chart shows a candlestick signal that formed at a hotspot on the chart during a bullish up trending market, that candlestick signal being the bullish rejection candle. The hot spot contains the 20 EMA and a daily swing point holding as support (support confirmed by the rejection candle). Perfect conditions to buy while the market is trending up.

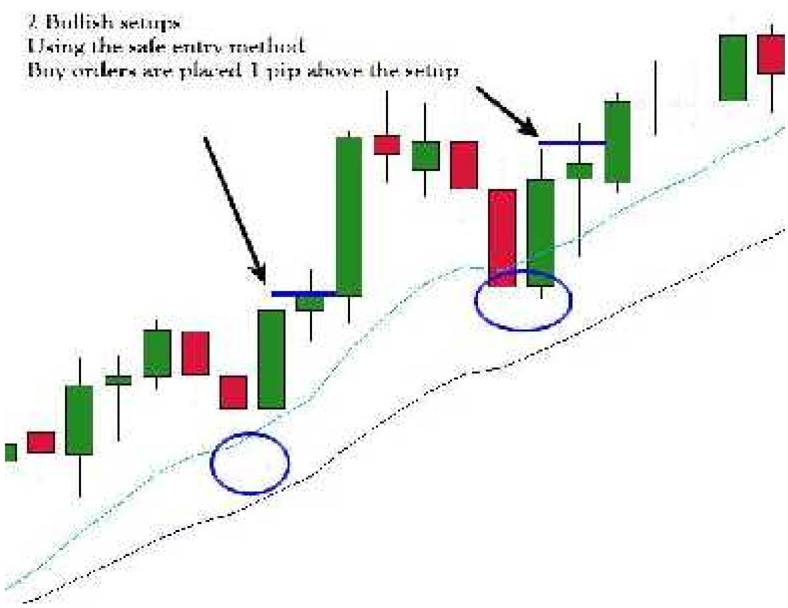
Entry Methods

So I've shown you the 3 rejection setups so far, but how do we enter them? There are actually a few ways you can enter these trades.

The Break of the High or Low

Let's say you're looking to trade a bullish setup. This entry method will be triggered with bullish momentum, and this gives added confirmation that the setup is working out in your favour. To enter using this method, simply put your buy order 1 pip above the high of the setup(don't forget to factor in the spread for all trades). For a bearish setup, simply place your sell order 1 pip below the low of the setup. When bearish momentum kicks in you will be triggered into the trade, with added confirmation that the setup is playing out as expected.

In the above chart, trades were triggered by placing orders 1 pip below the setups, and entered with bearish momentum. The chart to the left shows two bullish setups. Both trades were triggered by placing buy orders 1 pip above the high of the signal candle.

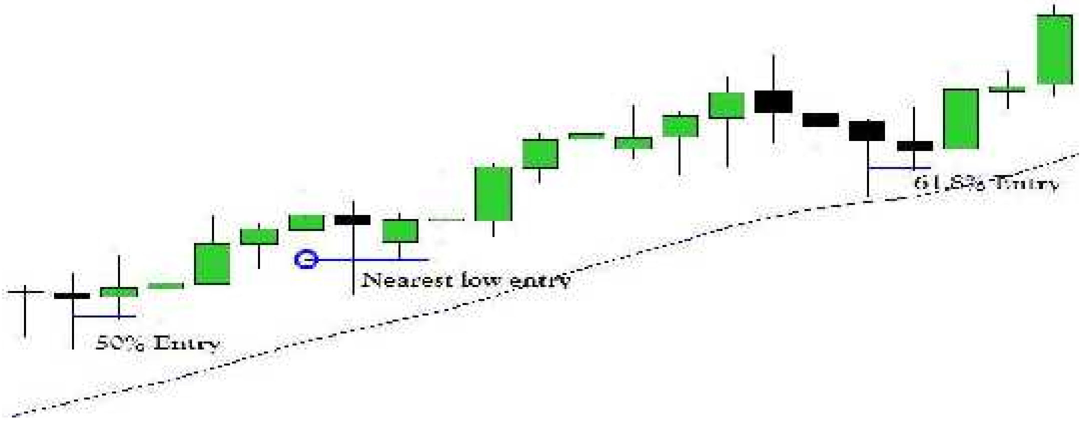


Entry Methods

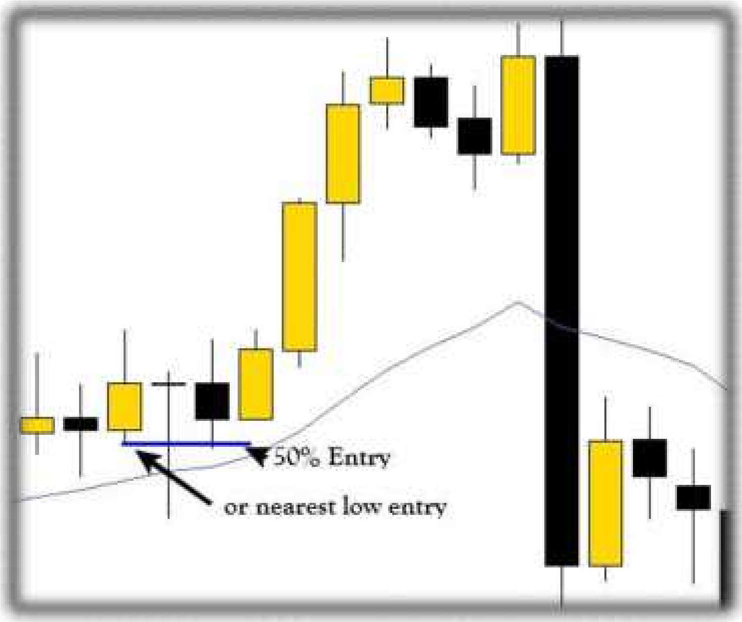
Entering on the break of the high or low of the signal candle is the safest entry method which gives that 'extra guarantee' that you have entered with the trade momentum. However, the downside to this method is you may have to use a large stop loss to cover all of the risk in the trade.

The retracement entry

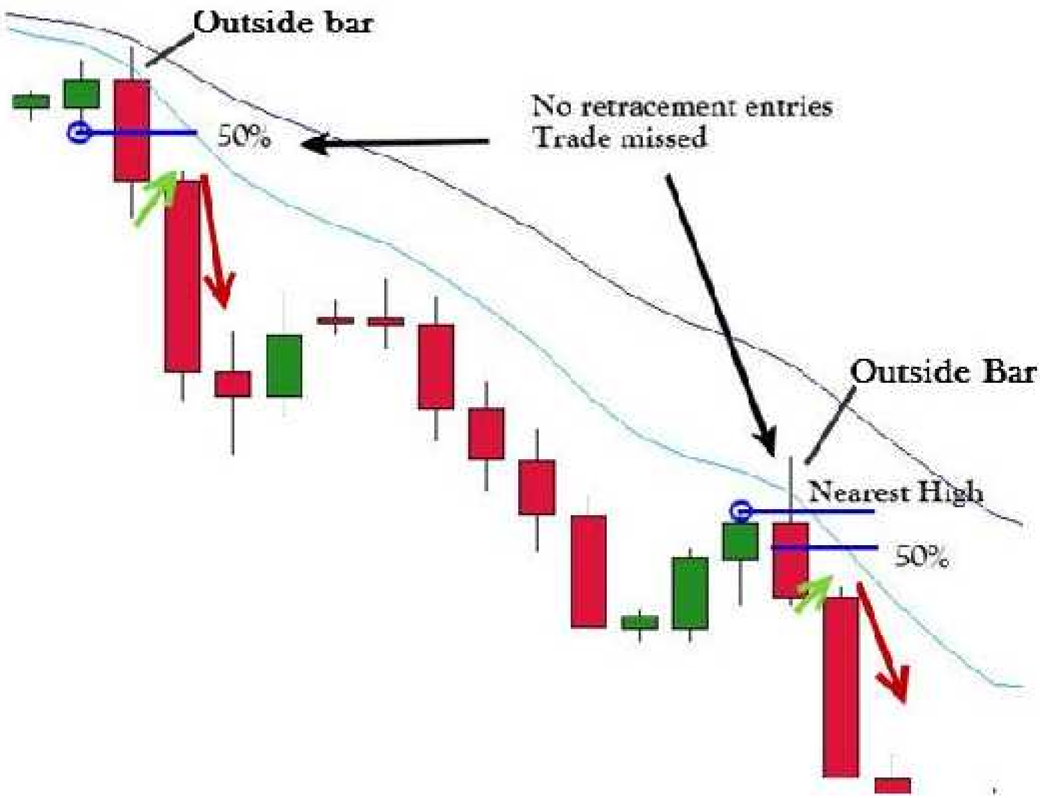
This method works on the principle that there is often a retracement before the trade takes off. Entering a trade via a retracement will let you enter the setup at a much better price than a break of the high/low, but it has its risks; you don't have the added bonus of knowing if the trade is working out like the safe entry method. Retracement entry areas can be the nearest low or high (the previous candle's low or high), or Fibonacci retracement areas, like the 50% or the 61.8% fib retrace levels. I personally favour the use the 50% level for retracement entries.



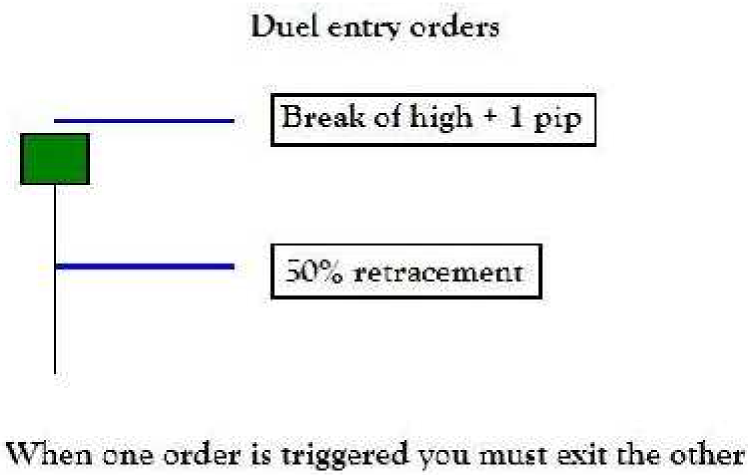
The above chart shows the three major retracement setups. The **nearest low/high retrace method** uses the previous candle's low or high as the retracement entry point. But there really is no way to know what retracement method to use on each setup beforehand. We can only see what would have worked after the setup took place. However, the 50% retrace entry would have worked on every single one of those setups. That is why it is my preferred entry method over the others; it simply offers the best price that works across most retracement entries.



The gold chart to the left shows a nice 50% retrace before it exploded. Notice how the 50% retrace area is also the nearest low as well.



The risk of using the **retracement entry** is that the trade may take off without you. The trade examples above hardly retraced before taking off, and we would have missed these opportunities. However, the break of the low plus 1 pip would have gotten us in the trade. But hold on, there is a way to get the best of both worlds here, simply by placing a retracement entry order AND a break of the low plus 1 pip order. Now you have 2 trade orders open. When one order gets triggered in, you must **close the order that is left un-triggered**. Leaving the second order open once the first has been triggered exposes you to unnecessary risk. If you can't monitor the situation because you're at work or unable to get to the computer etc, then the duel entry order method is not advisable.



Stop Loss Placement

The one rule that must always be obeyed when opening trades. IT MUST HAVE A STOP LOSS, NO EXCEPTIONS! We consider this to be the Unbreakable Rule of trading. When you first place a trade order, your stop loss should already be set in the trade execution order. We're aware that for many people, setting stop losses at order placement is not an option through certain broker's terminals; the best thing you can do in this situation is modify the order immediately after it's been placed, and set the stop loss. Do NOT allow a trade order to go live without a stop loss in place. Do not use 'mental stop losses' or say to yourself, 'I'll take care of it later'. An ill-timed power outage can do more damage to your account than almost any other event outside of your control.

When you place your stop loss, you place it at a logical price value that you know if breached by the market, the trade setup has failed. This means stop losses are placed at a **logical level,** not some random, "I'll just throw a 30 pip stop on the trade ". There are safe stop placements, and there are some 'tweaked' stop placements that offer better risk /reward, but a higher chance of being stopped out.

Stop Placement below the Low or High

The safest place for your stop loss is 1 pip below the low on a bullish setup, or 1 pip(plus the spread) above the high on a bearish setup. This way all your risk is covered, and you know if you were to get stopped out using this method the trade was not a success.

In the chart below , notice the bearish outside bar setup. Using this method, the stop loss is placed above the high + 1 pip. All the risk of the setup is now covered; if price was to break up past the outside bar high, the outside bar is no longer valid and the trade is a wipe.

Stop Loss Placement

When deciding where to place your stop loss, you must consider the entry method that you are using. When entering the trade with a retracement entry, placing your stop below the low of the setup (for bullish setups) or above the high (for bearish setups) works out to be an excellent combination. The retracement entry method ensures you get in on the trade at a good price, and this stop placement method ensures all risk is covered with the trade setup.

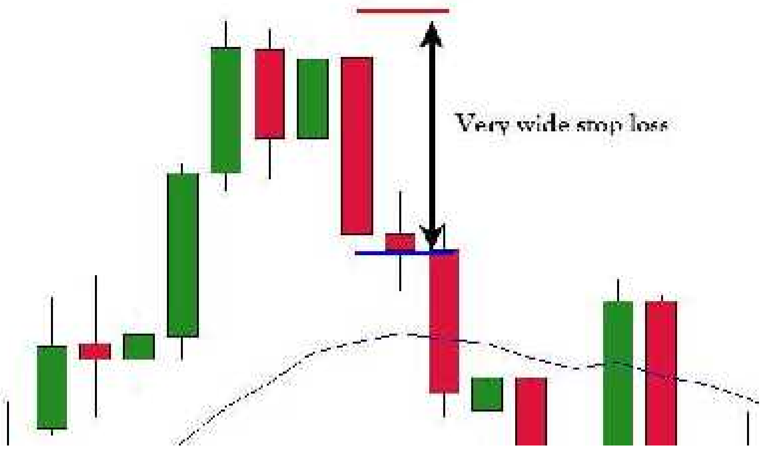
← The gold chart to the left shows an example of the retracement entry with the stop placed 1 pip + spread above the setup. This is the combination that I use most often, as it offers high risk/reward.

The example shown on the left is a retracement entry with a stop below the low on the bullish rejection candle setup. You can see how this combination allows for a tight stop loss and excellent risk/reward potential.

Stop Loss Placement

Now let's look at another entry/stop combination. What if you took the safe entry. For a bullish setup place the stop loss below the low minus 1 pip, then entered on the break of the high plus 1 pip, OR, for a bearish setup place the stop loss above the high plus 1 pip and the entry order below the low minus 1 pip. This would be the safest of all the combinations as it gets you in the trade with the momentum and your stop loss covers the risk of the whole setup. The only drawdown is this leads to a wide stop loss, meaning the distance from your entry point to your stop loss is high. This makes it harder to gain good risk/reward from your trade.

← An example trading a bullish rejection candle using this stop/entry combo. You can easily notice how large the stop loss becomes, the market has to move greater distances so you can achieve good risk/reward which can sometimes take an extended amount of time, this is the trade-off for using a safe entry combined with a safe stop loss level.



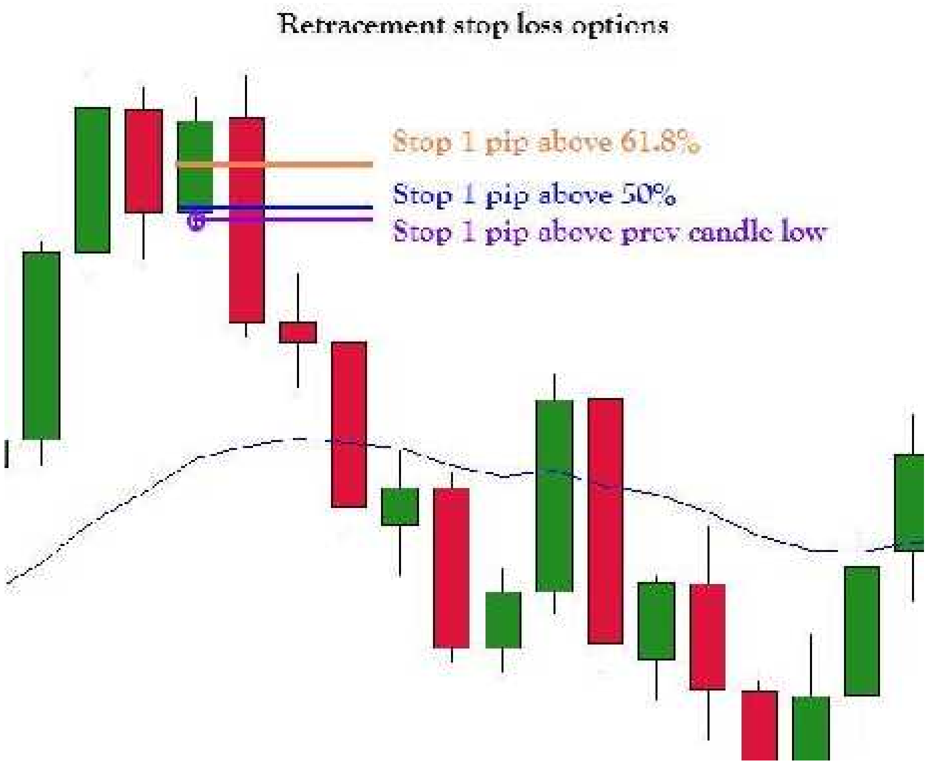
The above chart shows a bearish outside bar setup. Placing an entry at the low – 1 pip and placing the stop loss above the high + 1 pip leaves us with an extremely wide stop, which is not desirable at all. There was also no opportunity here to enter via a retracement entry. The stop loss needs to be placed closer to the trade entry to tighten up the stop loss distance.

Stop Loss at retracement levels

So as we've seen, some trades just need too wide of a stop loss using the first stop loss method. When combined with the break of the low/high entry method, this damages the risk/reward potential and makes the trade undesirable. We need to place the stop loss at a retracement level to tighten the stop distance.

Just like the **retracement entry**, you can use the same options you have for that method as stop loss placements. The 50% or 61.8% Fibonacci levels or the closest high/low (the high/low from the previous candle).

Let's look at the same trade again…



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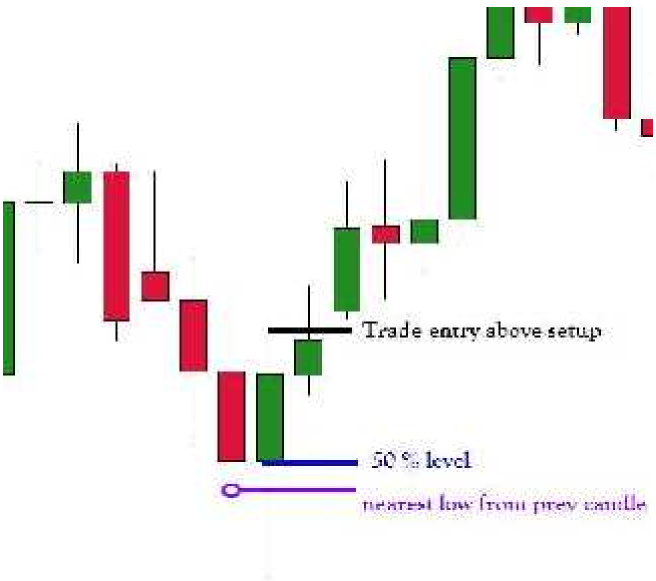
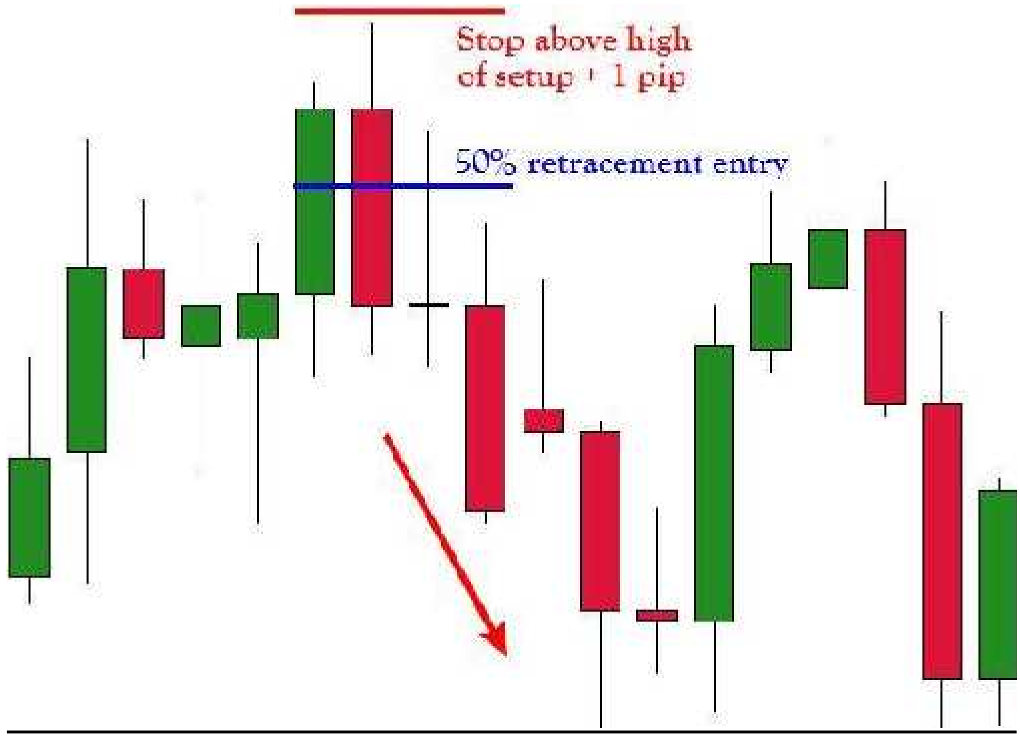
See how we can use the retracement areas for stop loss placement. This greatly reduces the stop loss distance and brings good risk reward potential to the trade. However, not without its risks. The stop loss does not cover the risk of the whole trade setup anymore. When using retracement values for stop losses you must use the **break of the low/high entry method**, this way you will be triggered in with momentum and the risk of a deep retracement will be minimal and this offsets the risk taken when using a retracement level stop. It is recommended that this type of entry/stop combination placement should **only be really used in trending markets**.

Stop Loss Placement



← This bullish rejection candle was triggered by using an entry trigger above the high of the setup. There was no opportunity for a 'retracement entry'. Using a stop below the low of the setup would be undesirable because of the wide stop loss it would generate. So we can look to place our stop loss level at one of the retracement zones. Just like the retracement entry system, I like to use the 50% level for my stop loss area.

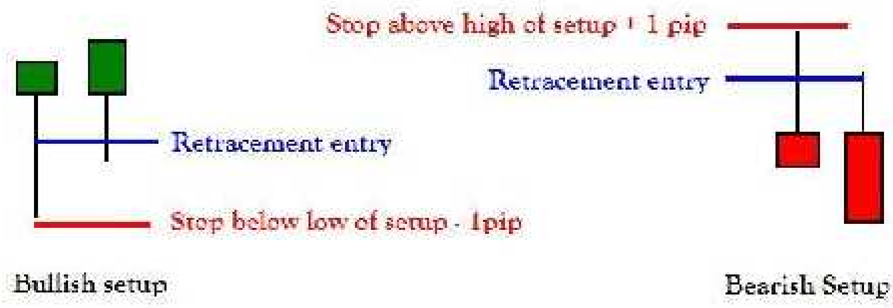


Any of the stop loss/entry combinations can be applied to these setups. See above how a 50% retrace entry offered a good entry price to this bearish 2 bar reversal setup. The tigher you make your stop loss, the greater the risk to the trade, but at the same time increasing the risk/reward potential of your trade.

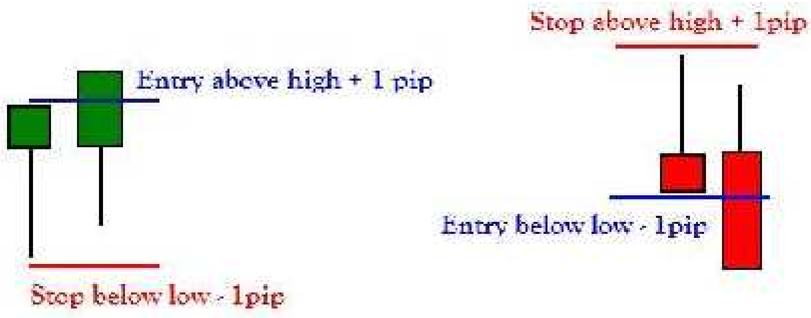
Stop Loss Placement

Stop loss / Entry combo examples

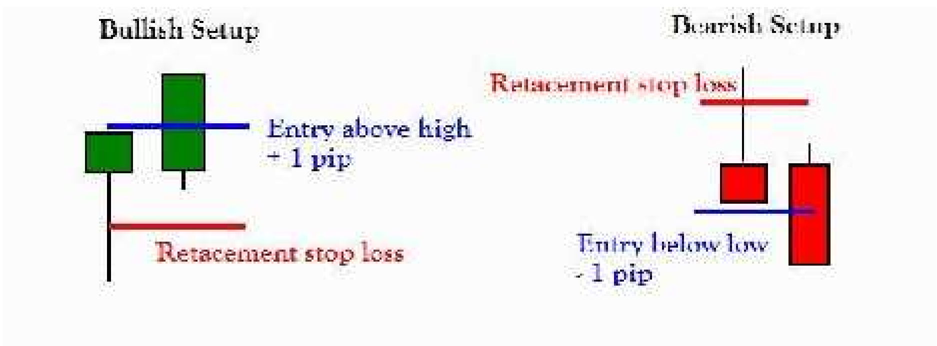
Retracement entry / stop at high/low of setup combo



Entry with momentum / stop at high/low of setup combo



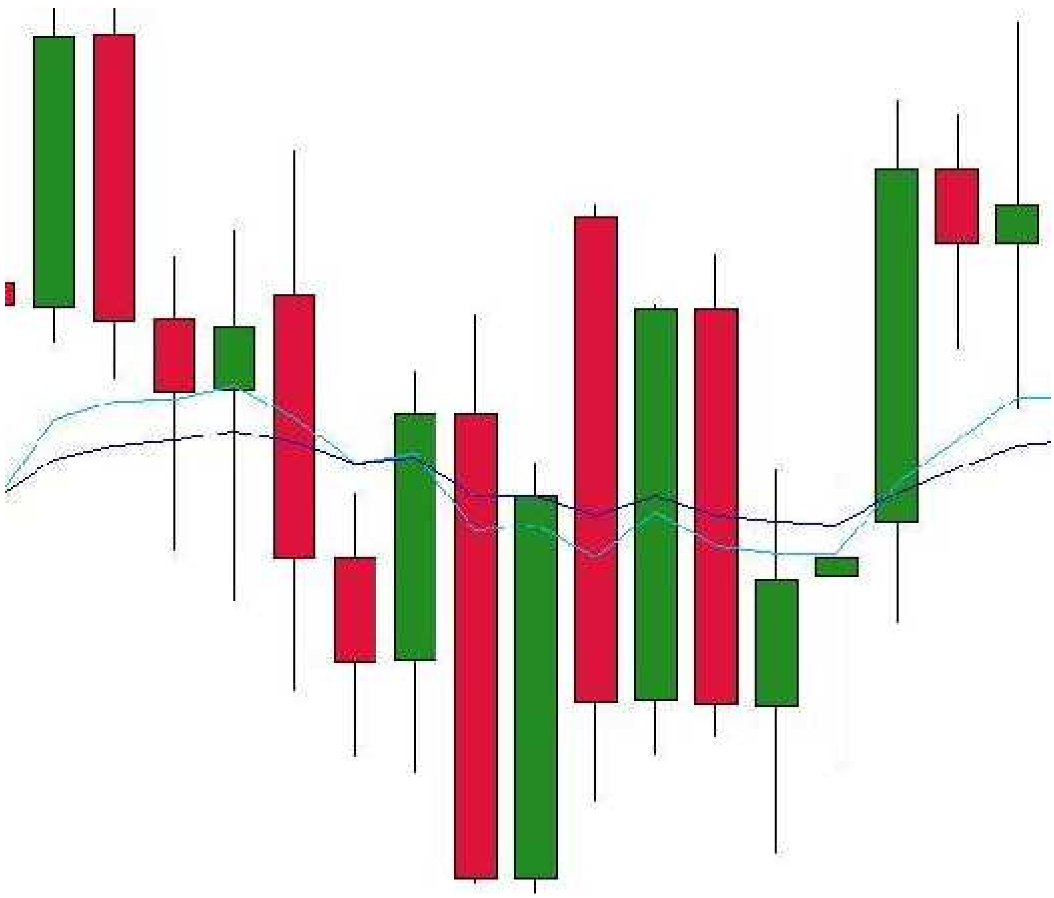
Entry with momentum / retracement stop combo



Consolidation

Consolidation: What Is It?

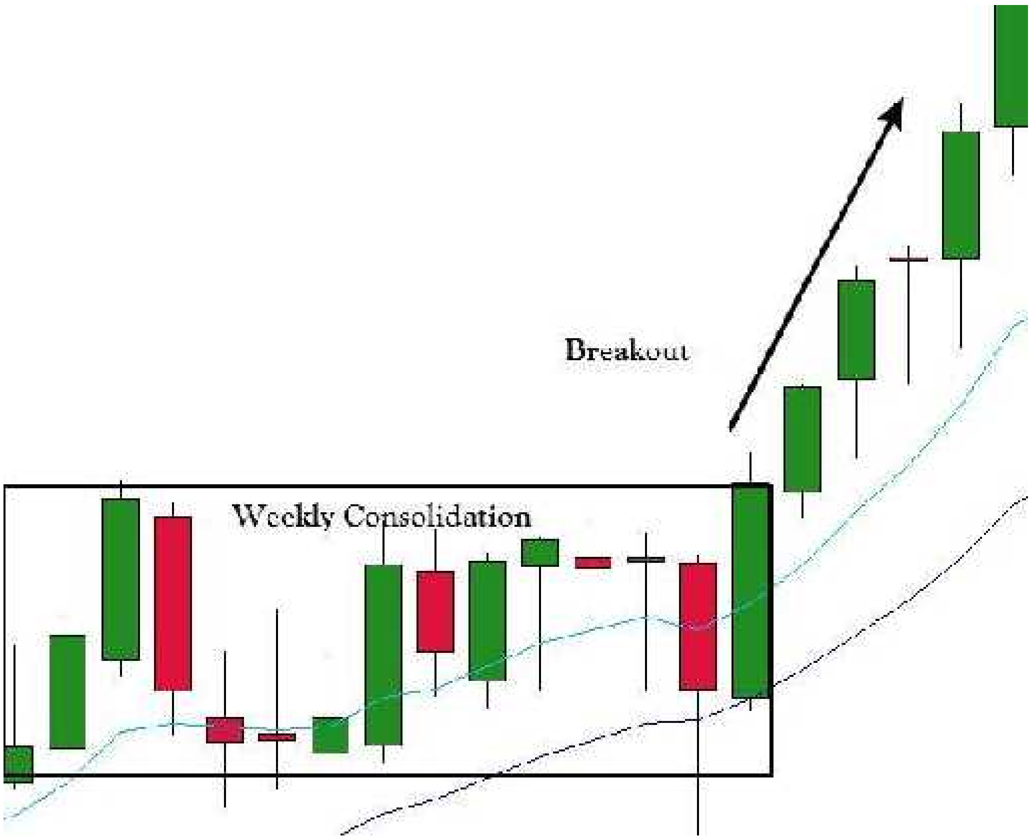
Consolidation is basically a **period of indecision**. It can happen on any time frame, and can strike at anytime. Consolidation periods can last anywhere from as little as five minutes, to five hours, to several days, weeks, or even months in some cases. When markets are consolidating, price is essentially not moving in any particular direction, but appears to be 'stuck' in an area, moving up and down erratically as large amounts of money is changing hands, causing a mess on the charts. One example of this is large commercial companies and large trading firms switching positions in the market. As this large amount of money changes hands there is no clear trend direction, just the noise caused by the big players in the market.



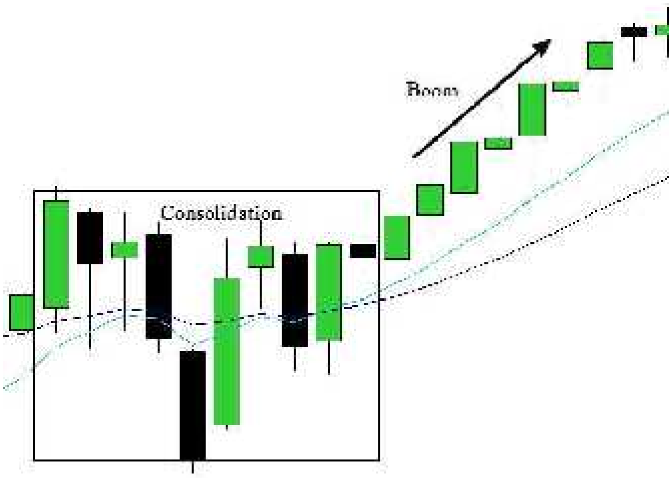
This is the Daily EURUSD chart of 2011 when the market started consolidating badly, because of the bad news that was plaguing the Eurozone. Previously markets were bullish on the EURO but as bad news was flooding out of the Eurozone, big players in the markets started changing position. Commercial companies started buying up the Euro while it was still high in value, and large speculators were getting out of their long trades and positioning short. This extreme rapid buying and selling between the 2 main players in the market caused massive consolidation. You're looking at the noise created by the two as they exchange large amounts of currency/goods/stocks.

Consolidation Breakouts

So how do we capitalize on a mess like that? The answer is quite simple: We don't trade. Our objective is to trade the breakout of the consolidation period, not the consolidation itself. Consolidation breakouts can be extremely powerful, and kick off some large moves, even start new trends. A general rule of thumb is "the longer the consolidation, the more explosive the breakout will be." Think about a consolidation period that has been churning away on the weekly chart for a long period of time; you can imagine how intense a breakout from that sort consolidation would be!

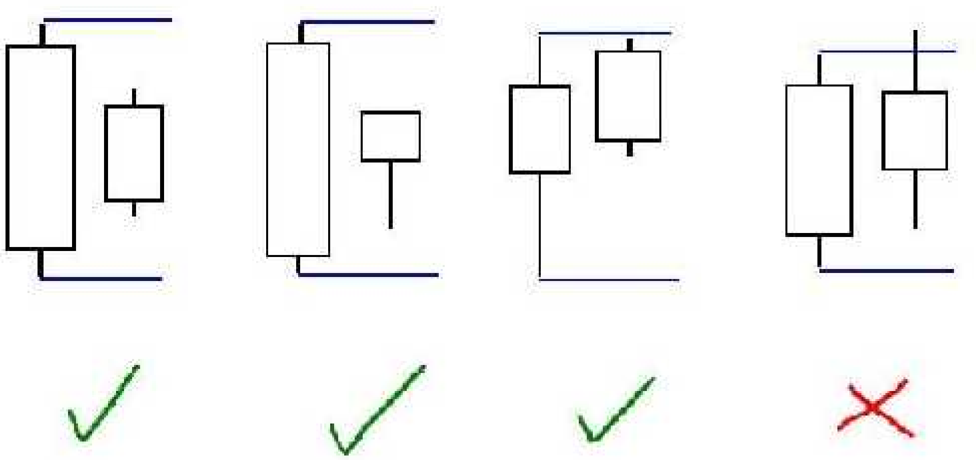


As you can see in the chart examples, breakouts from large consolidation can be very explosive. Again, we are looking at high timeframes. Consolidation that is significant should have our attention; a lot of traders either try to trade during the consolidation period and get stopped out from the choppy conditions, or ignore that particular market because it has been a mess. Be patient and wait for an obvious breakout.



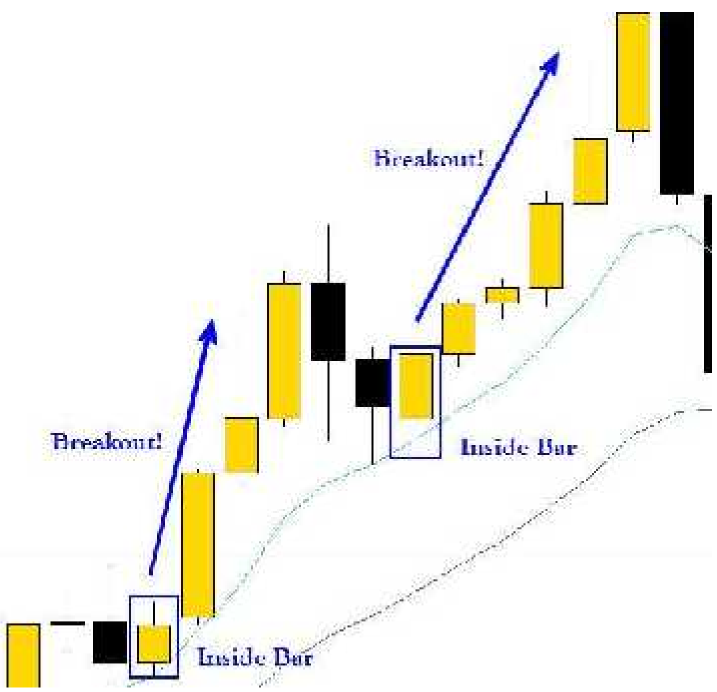
The Inside Bar

The inside bar is a candle that is completely inside the previous candle's range, including its highs and lows. Some people confuse inside bars with candles that have a body that is inside its previous candles range, but the highs and lows are not.



You can see in the examples above, all the valid inside bars highs & lows are within the previous candle's high and low. The last example shows that the body was within the previous bars range, but the high was not. This is **not** an inside bar.

Inside bars are basically a candle that has formed from a period of consolidation/indecision. I only trade Daily Inside Bars. When a Daily Inside Bar forms, have a peek at the lower timeframes and you will find some consolidation. Inside bars are common, but not all of them are good signals. Inside bars can cause some powerful breakouts and these are moves we want to catch.



The Inside Bar

Inside Bars work best in trending markets, trading breakouts in the direction of the trend. Inside bars are diverse in the way they can be traded; Inside Bars that form within a trend are used as **trend continuation signals**. Inside bars that form at major support and resistance levels can act as a **stalling/stopping signal**. In rare cases they can even be a **reversal signal**.

The close direction of an Inside Bar is usually a good tip off which way it wants to break out. Especially if the Inside bar body is thick and the inside bar doesn't have tails sticking out its ends.

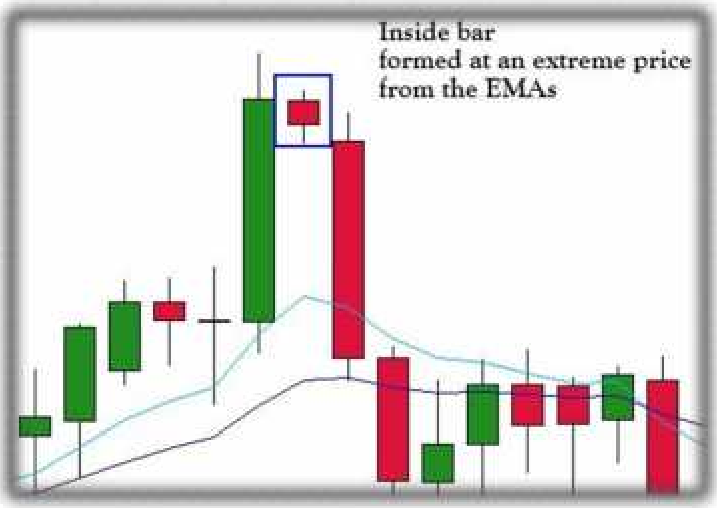
The **standard** way to enter an Inside bar is using the entry above the high/low of the IB & stop on the opposite of the IB, covering the full risk of the setup.

The chart to the left shows a bullish breakout of an Inside Bar. The Inside Bar formed in an uptrend (notice the EMAs are up), the setup formed near the EMAs, and it had a nice bullish close on it, hinting to us that a bullish breakout and trend continuation is a high probability. This Inside Bar showed price **stalling** right at the 20 EMA.

To the right, EURJPY produced an Inside Bar chain. The longer the period of consolidation, the bigger the breakout will be and this setup exploded. We can see from the EMAs the trend is down. Before the inside bar cluster there was a bearish rejection candle off the EMAs hinting a sell off. To enter multiple IB setups like this one you can use the first IB, because it should be the largest that formed, as your high/low entry points and stop loss reference.

The Inside Bar

In the example to the right, we have an inside bar that was used as a **reversal** signal. We know that when price acclerates away from the EMAs, the attraction between price becomes greater. This inside bar gave us the perfect opportunity to catch the move back down.



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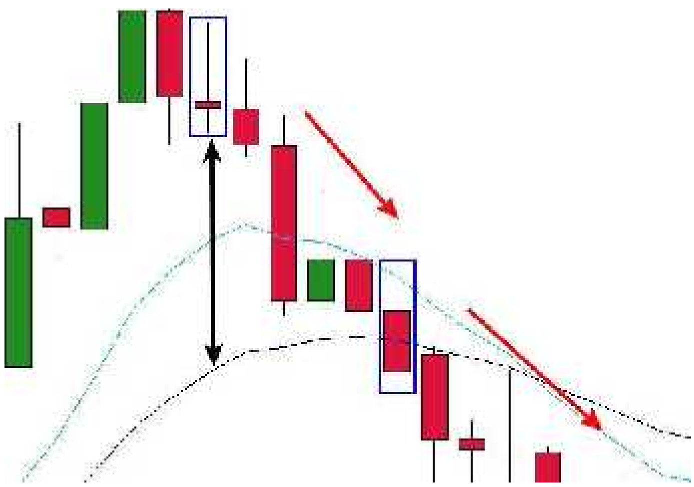
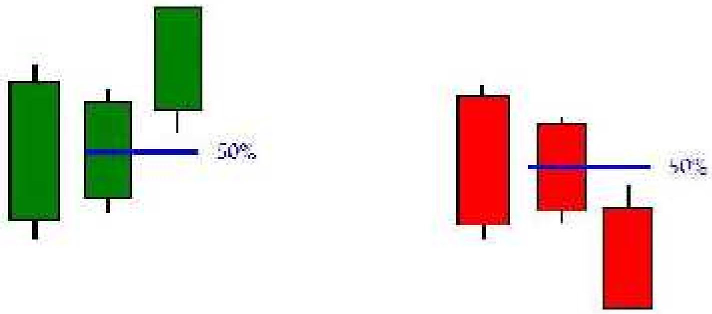


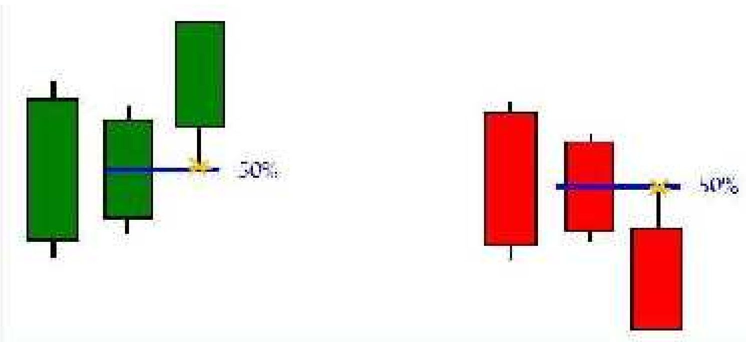
The 50% Rule

After an Inside bar forms, one observation I have made is that the setups that don't retrace past their 50% level before the breakout, work the best. This rule mainly applies to Inside bars that have a body which take up the majority of the whole inside bar range.

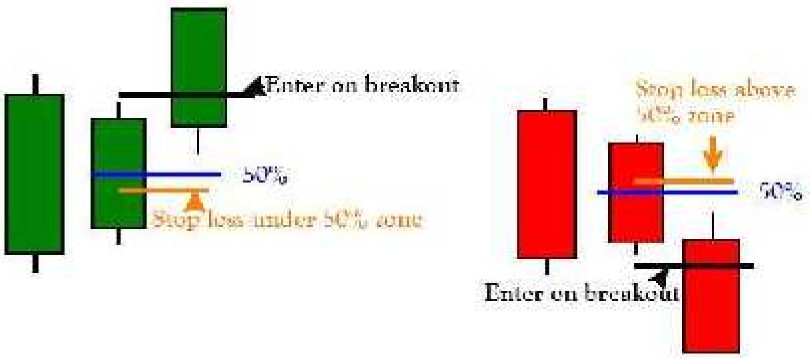


If the setup does breach the 50% retrace level before breaking out, the probability of the setup working out in our favour is lower, but not completely ruled out.

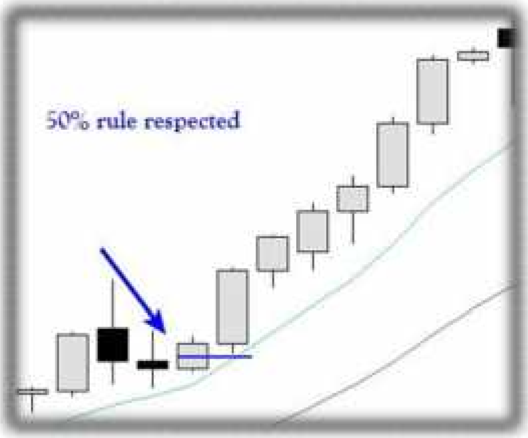
Inside bar setups that retrace **exactly** to their 50% retracement level and continue in the right direction are even higher in quality.



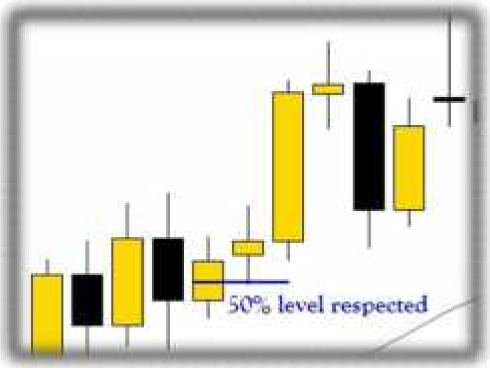
So when entering Inside Bars that have respected the 50% rule, you can enter on the breakout and place you stop just under or over the 50% area, depending on if the setup is bullish or bearish. This however is optional and does add more risk to the trade, but better reward.



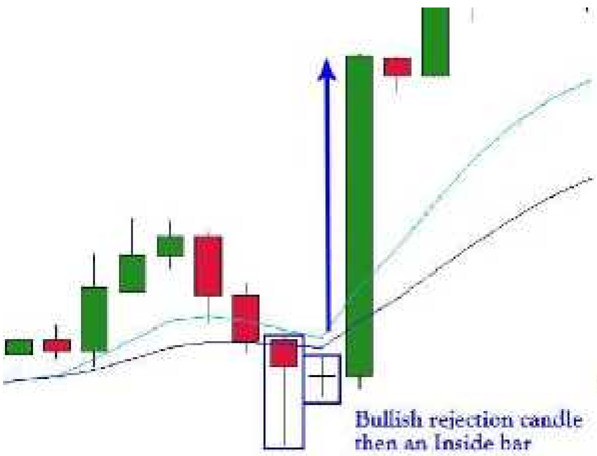
The Inside Bar



Notice in the examples above how both Inside Bars broke out, while respecting the 50% rule. Both Inside Bars had a body which took up most of the candle range, and closed in favour of the trend.

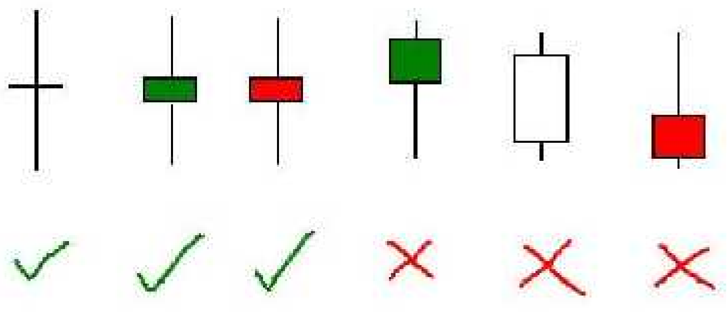


In the setup shown above (left) on the Daily Chart of Gold, you can see how the 50% retrace level was respected completely. Also, be wary of Inside Bars that breakout during the **early Asian session**. **Breakouts around this time tend to be false moves**. Don't get trapped by taking early Asia breakouts!



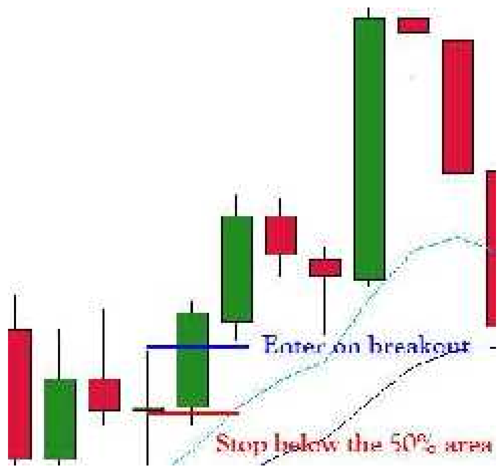
The Indecision Bar

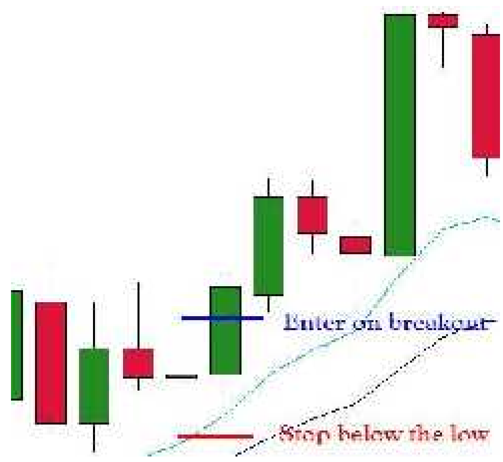
Similar to the Inside bar, this candle shows a period of consolidation/indecision. However, it does **not** need to be inside the previous candle's range. The Indecision Bar has a centred body with tails protruding from each end. Common names for these candles are 'spinning top, doji, and neutral candle'.



As you can see in the examples, the indecision bar has a small body that is centred in the candle range; the close is near the open and there are tails sticking out both ends of the body. This tells us during the candle period price went nowhere, it simply consolidated. There was **price indecision**.

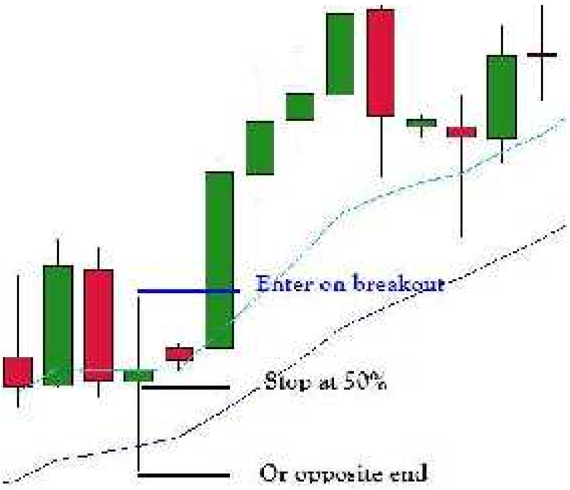
Indecision Bars are traded very similar to inside bars, best traded during trending markets, close to the EMAs, and taking the breakout in the direction of the trend.

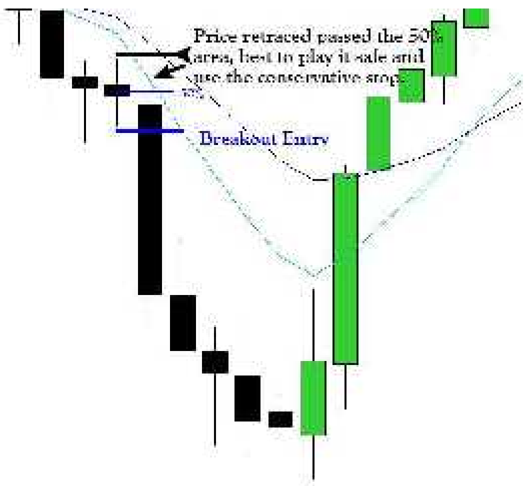




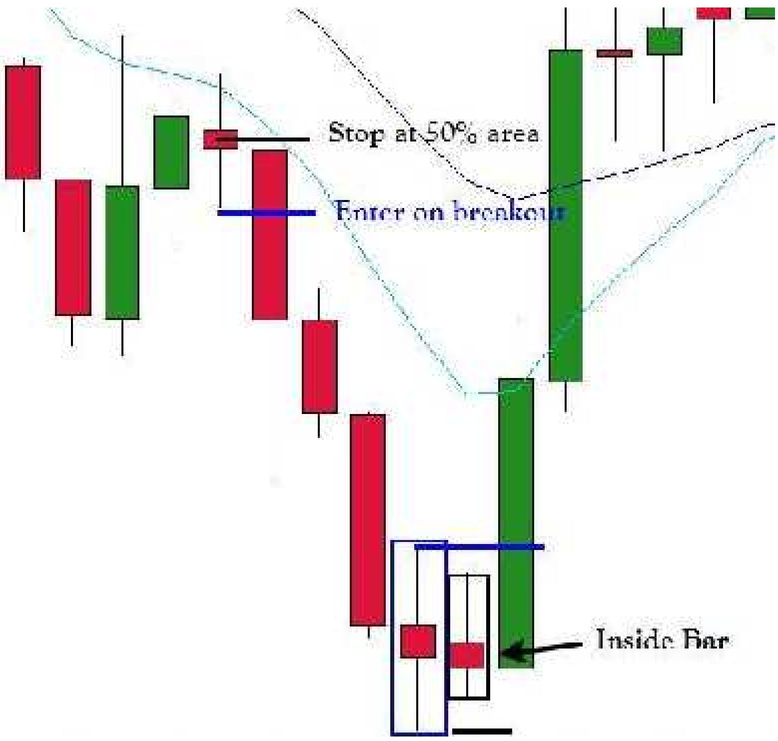
Just like inside bars, you enter with the breakout in line with the trend. The stop loss can be placed at the opposite side to the setup, or you can place the stop loss in the 50% area, which will add risk to the trade but increase reward potential. The best indecision bar setups are the ones that don't retrace very much, price charges straight up to the top or bottom of the candle and triggers you in with the breakout. This is where we can take advantage of placing the stop loss at the 50 % area. If price retraces further past the 50% level a lot before breaking out, then it's best not to use the 50% stop approach. Remember not to take indecision candle trades unless they are reacting with the EMA's, resting on some support or resistance, a swing point or strong trend line.

The Indecision Bar





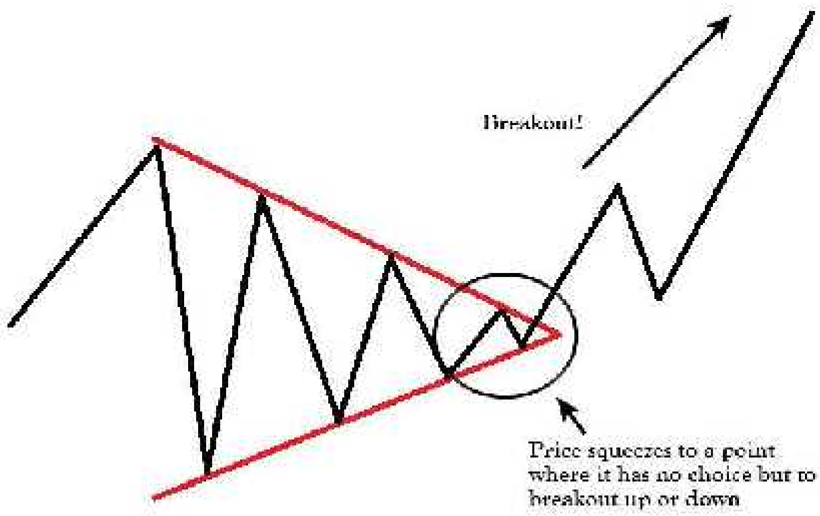
See in the example below, the first Indecision bar setup charged straight down and triggered a breakout, a good example where the 50% stop loss can be used. The next Indecision Bar forms very far away from the EMAs, to catch the price slingshot back we look for a bullish breakout. However, price retraced further than the 50% level, so we would have needed to use the opposite side of the candle for our stop loss, which leaves the distance between the entry and stop undesirably wide. Fortunately for us, the next candle was an Inside Bar, which we could have traded, offering a better stop loss and entry point.



The Price Squeeze Pattern

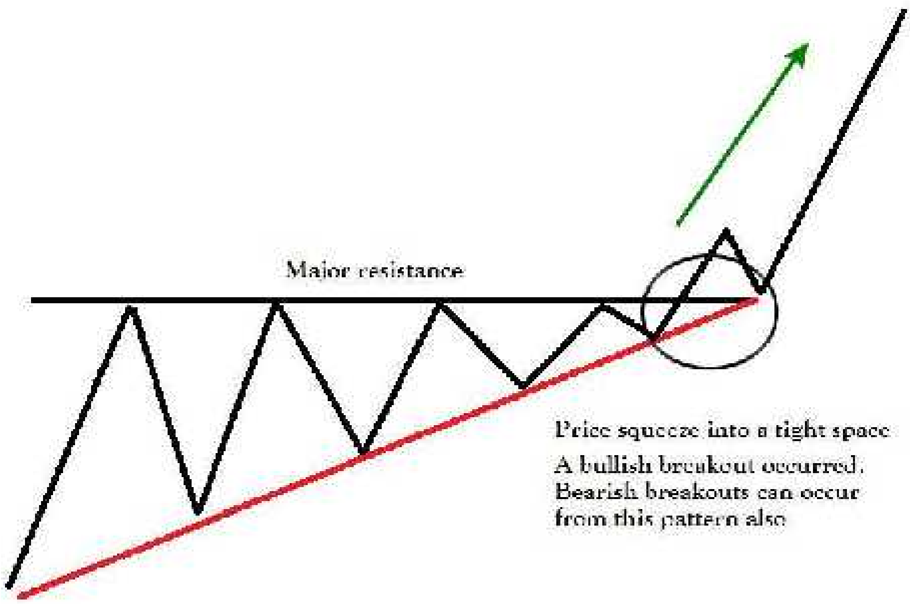
This is not a candlestick setup; it is a chart pattern based upon information from a large group of candles. Not all consolidation is messy and chaotic; sometimes there are obvious consolidation patterns that we can mark on our charts, and wait for a breakout. As the name suggests, we are waiting for price to squeeze into a situation where there is nowhere else to go but break up, or break down.

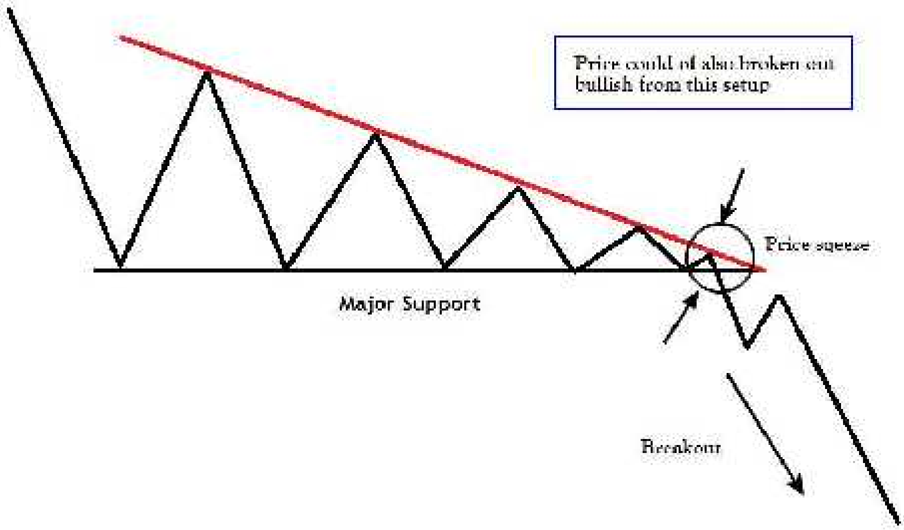
The first pattern is where price squeezes into a wedge. This is also known as a 'pennant'.



The Price Squeeze Pattern

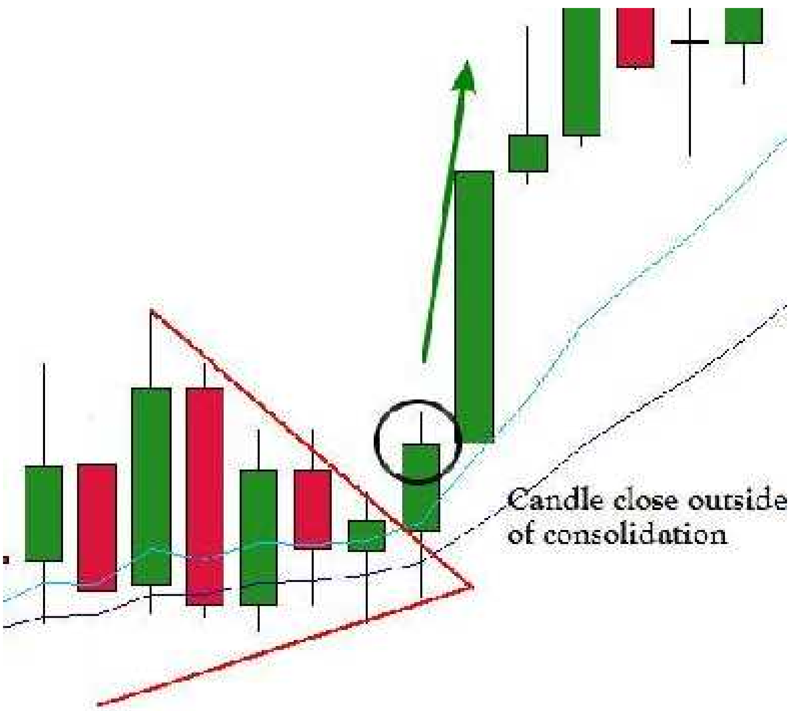
Another type of consolidation squeeze is when price squeezes itself between a support or resistance level and a trend line. Price will consolidate and squeeze itself tighter and tighter, until it bursts through the support or resistance level, or the support/resistance will hold and price will break out of the pattern in the other direction.





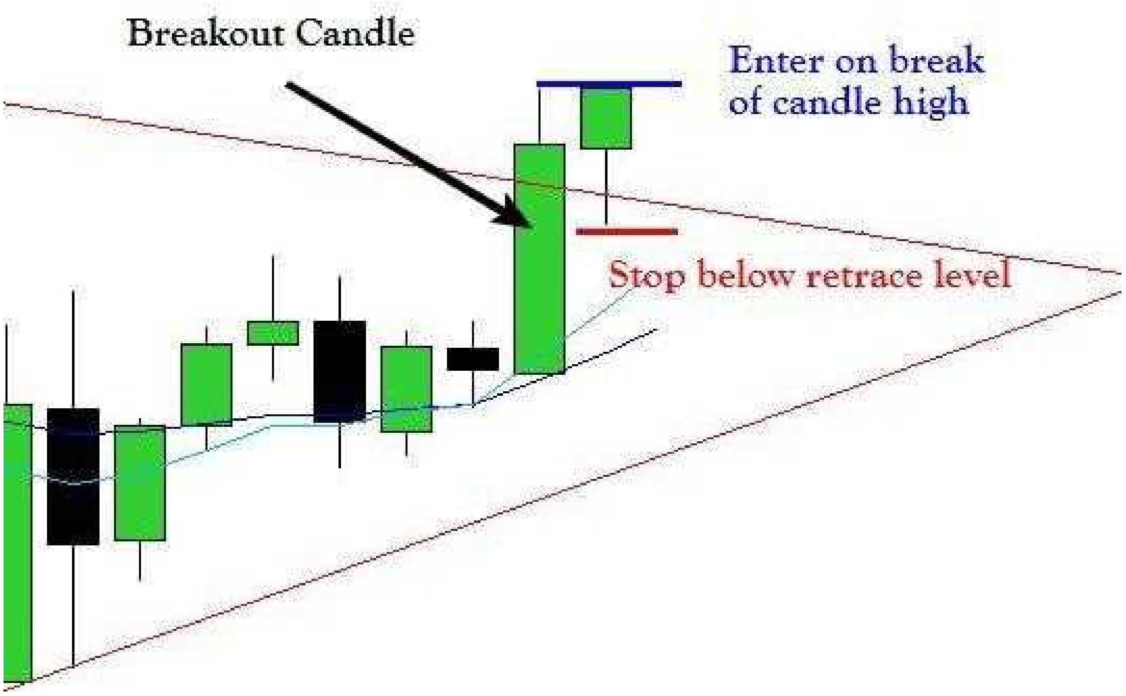
So with any price squeeze pattern you spot on the chart, the direction of the breakout can happen in either direction. Don’t assume it will breakout one way and try entering early on assumption.

There are two ways to enter these setups. The first is to simply **buy or sell as price breaks out** of the consolidation pattern, OR, you **wait for a candle to close outside the pattern**, giving a clear indication that is the direction price wants to go



Entering once a candle has closed outside the consolidation pattern is the safest way to enter these breakouts, however stop placement can be tricky. The safest place for your stop loss is on the other side of the breakout candle. If you want to try tightening your stop loss, move down the 4h chart and place your stop **under the last swing low** or **above the last swing high**, depending on which direction you're trading. It may also be possible to grab a **retracement entry** on the breakout candle.

Another way to enter the breakout is to wait for a candle to close outside of the consolidation pattern, which confirms a breakout. Then wait for price to retrace down that candle's range, turn around, continue in the breakout direction, and **enter on the break of the breakout candle's high or low**. This method gives you a new area to place your stop loss, above or below the retracement level before the breakout candle's high or low was breached.



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As you can see this method allows for a tighter stop loss. You can also apply the **50% rule** here, if price retraces further than the 50% area of the breakout candle, then it is probably not a good idea to enter using this method. However there is no rush, if you haven't been able to get in on the breakout because the stop loss needed was too wide, or price retraced past the 50% area of the break out candle, breaking the 50% rule, just be patient. There will most likely be another signal to enter in this movement soon enough, such as an Inside Bar or a Rejection candle. Don't try force a trade out of these breakouts. Patience is key; there will always be another setup around the corner.

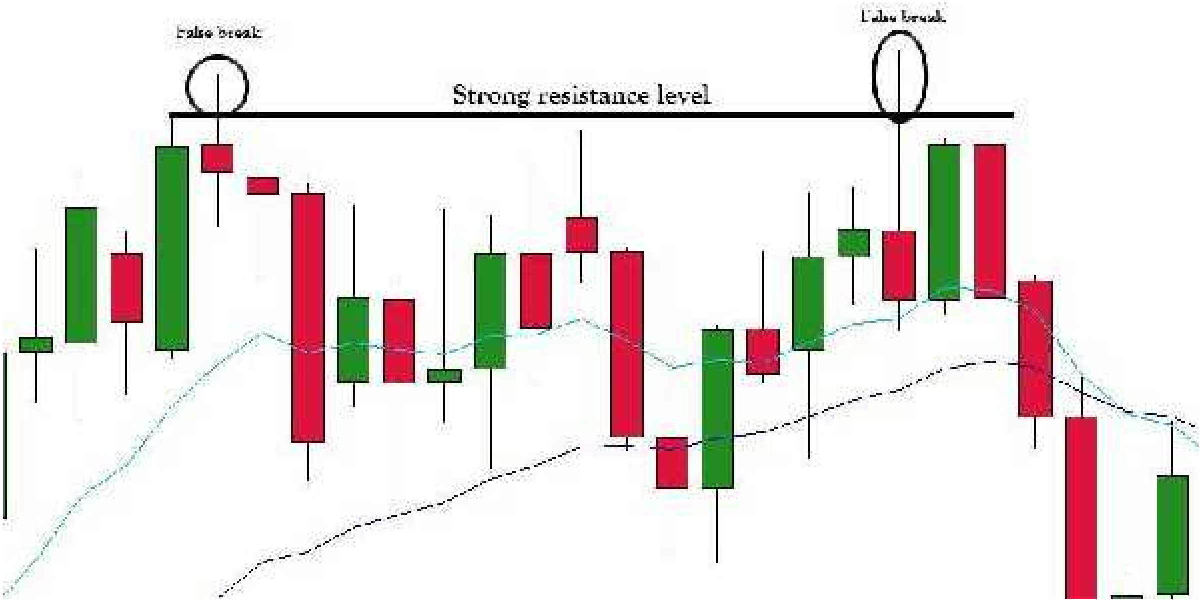
False Breakouts

One risk with trading breakout patterns is **false breakouts.** False breakouts happen when a breakout occurs, but the big players are not participating in the move, because they really want to trade in the opposite direction. This false move created by all the small fish in the market, presents an opportunity to the big fish which they use to their advantage. The big players are now getting in their positions at a better price, trapping in all the small players that are jumping in on this false move. Price quickly turns around as the smart money positions in, leaving on the chart a false break.

False breakouts can happen with any consolidation breakout pattern; they can happen at strong support and resistance levels, and even at the tops and bottoms of ranging markets.

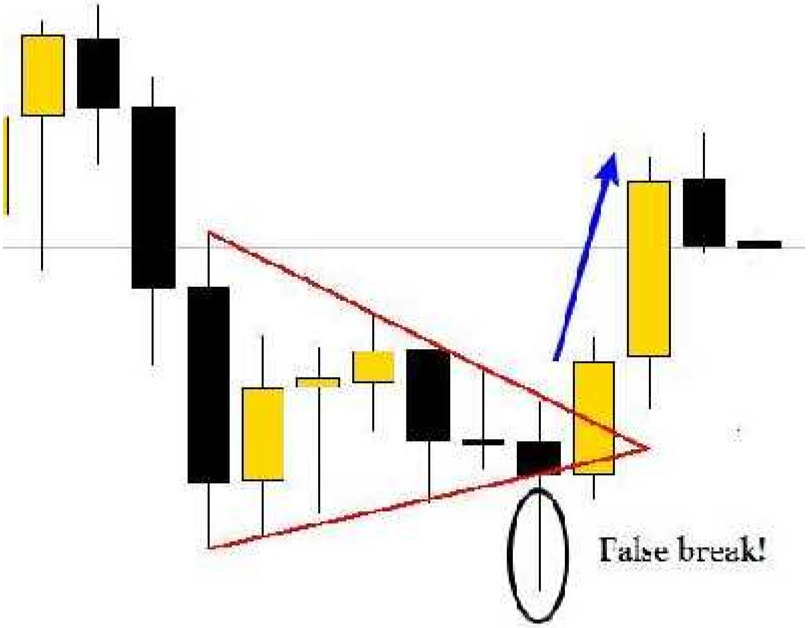
Some ways to avoid false breakouts is to trade in the direction of the trend close to the EMAs**. Don't buy into major resistance** or **sell into major support** without a very good reason. With price squeeze patterns, wait for a candle to close outside the pattern, confirming a breakout instead of just buying or selling breaks as they happen.

However, false breaks can be used as a trade signal, because we know when a breakout fails, it was because the breakout was fuelled by small traders, and then large traders stepped in and traded against the move. We want to be trading in the same direction as the large money in the market and this false break just tipped us off to which direction they're going.

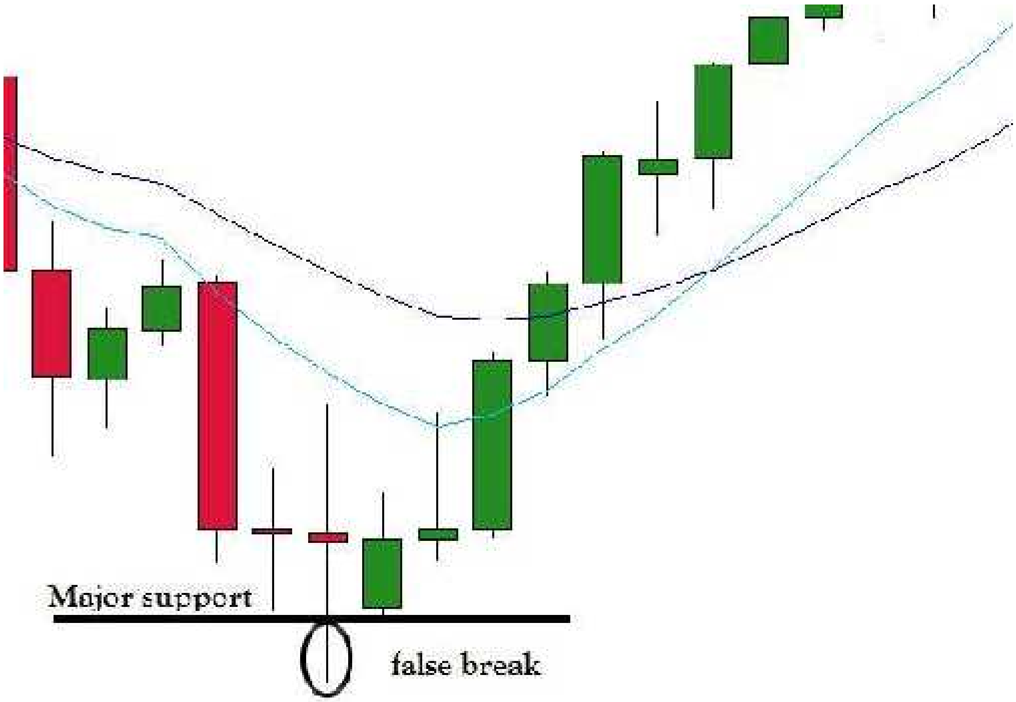


As you can see in the above example, there were 2 false breakouts of this major resistance level, leaving a tail poking through the resistance line. We can see how the market tried to break to the upside, with no interest from the large traders, trapping anyone who jumped in on the breakout as the large traders positioned themselves short.

False breakouts are usually accompanied by a signal. This example shows an indecision bar with a bearish tone in its body, and then the second false break left behind a bearish rejection bar with a nice bearish tone in its body.



← This example shows why it is best to wait for a candle to close when looking to trade consolidation breakouts like this price squeeze pattern. A false break to the downside would have trapped a lot of traders, only to have closed back into the consolidation and dropping a bullish rejection candle in the process.



The chart above shows a false break of major support on the GBPUSD. The false break event also dropped an indecision candle, which had a wide range. However, the next candle was an Inside Bar with a nice bullish tone to its body. This inside bar obeyed the 50% rule, and if traded with a stop below the 50% level, and entering the breakout of the Inside Bar, would have generated a very tidy profit.

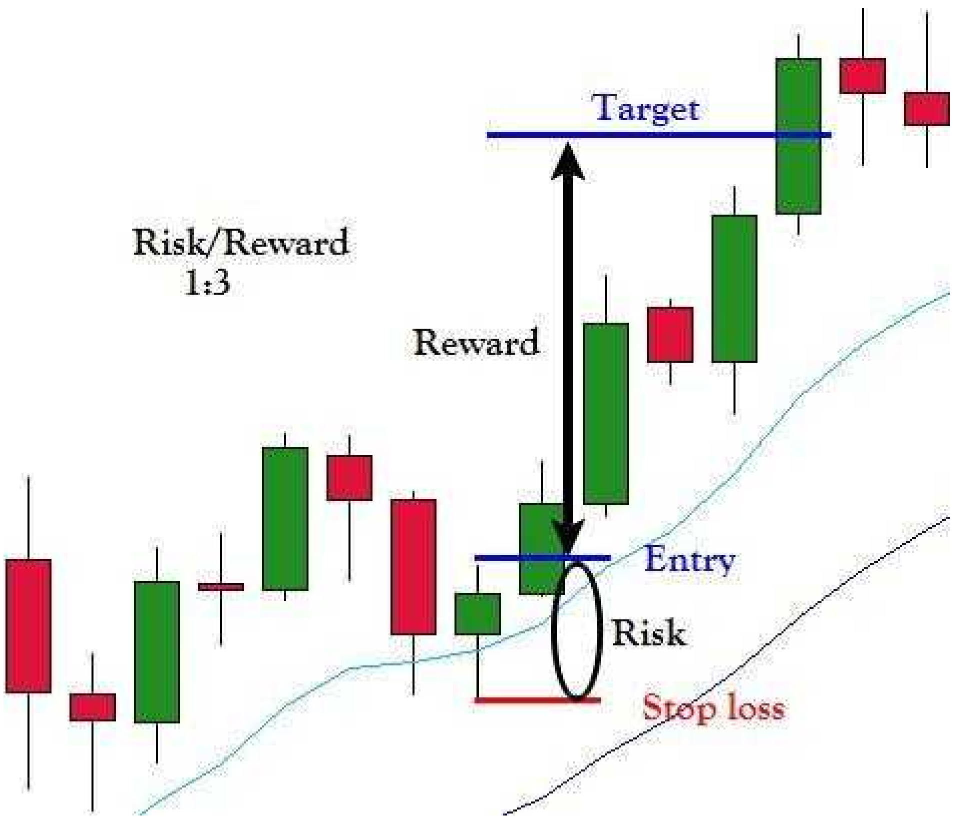
Money Management

Up until this point, we haven't yet talked about where to set targets, or how to manage the money you're trading with. It is a crucial subject, because without any money management plan, failure in the markets is almost certain.

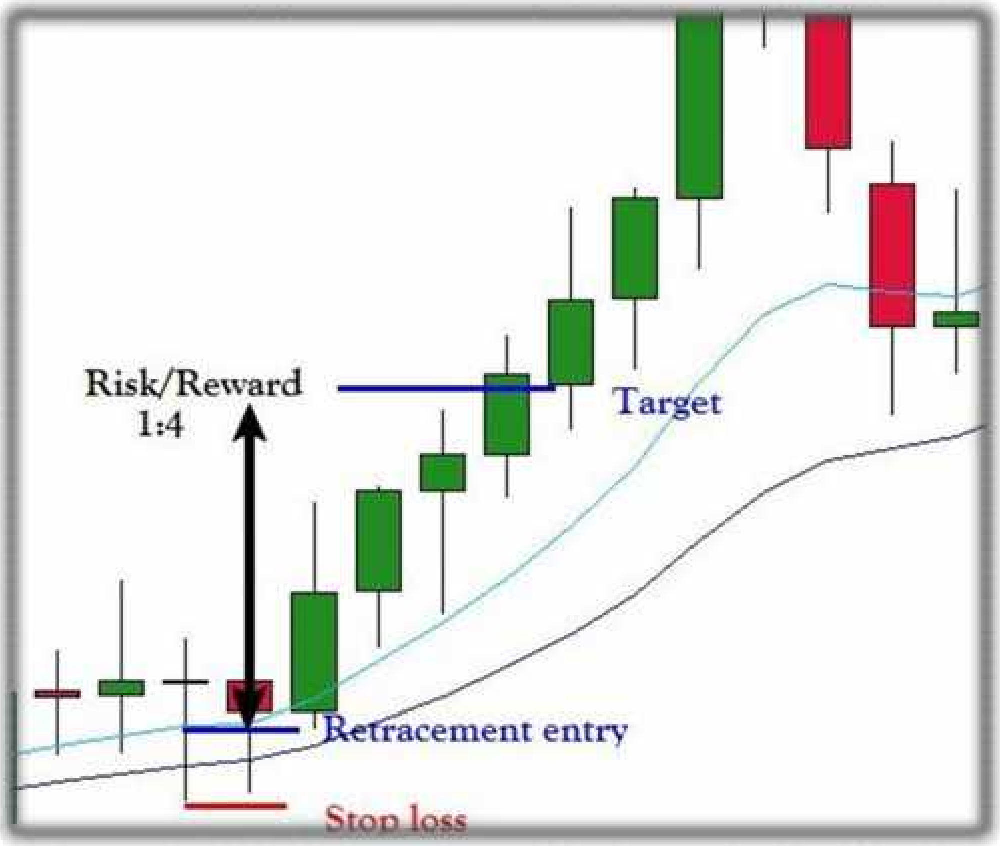
Trading profitably is all about how much money you're risking vs. how much money you're expecting to gain in return. If you're risking $200 and are only aiming for a target of a $50 return, you're going to have a hard time making money. Because each time you lose a trade, you lose $200 and will need to win 4 trades in a row just to make up for the loss. What happens when you get stopped out 3 times in a row? You're now down $600, which means you now need to make 12 winning trades **in a row** to regain your previous balance. It's not going to work.

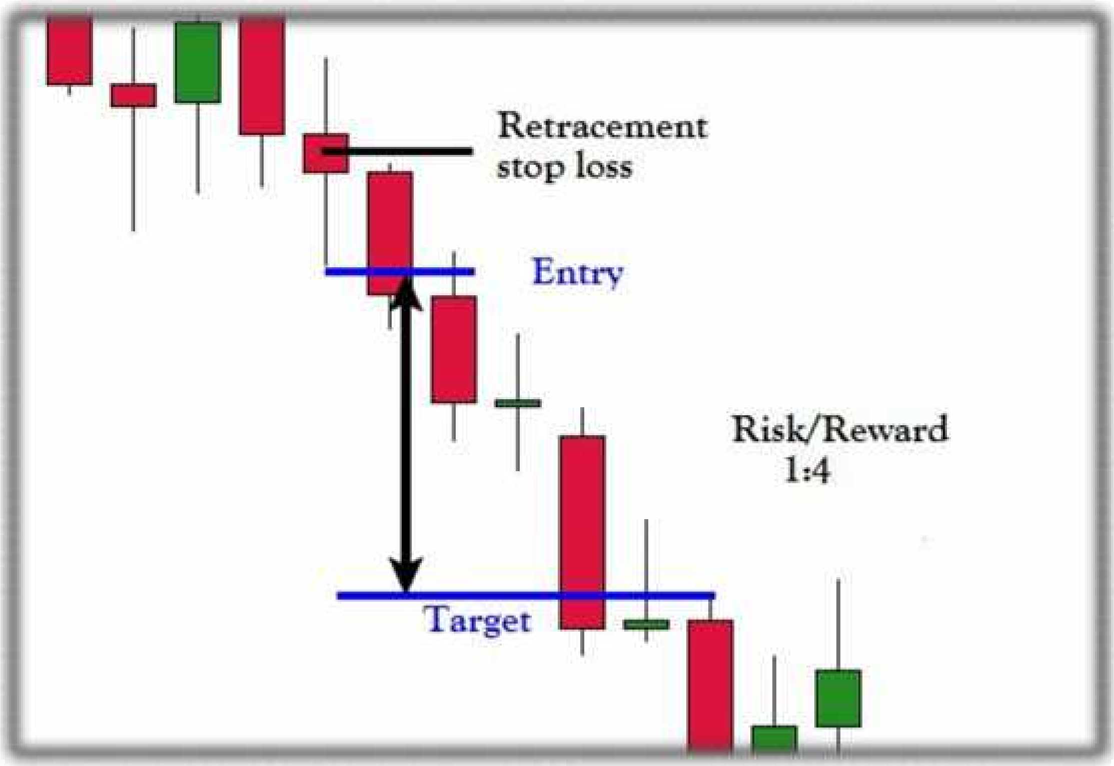
Now with $200 risk, and aiming for a $200 return, will give you a risk/reward of 1:1. This means you must simply win more trades than you lose to make money, but still that's not good enough.

Let's say we aim for a $400 return on $200 risk, giving us a risk/reward ratio of 1:2. Now, we could lose **50%** of our trades, and still make money. With 1:3 risk/reward, we could have an overall win rate of 25%, and **still** turn a profit! At a bare minimum, aim for **at least** 1:2, but don't aim for a ridiculous risk/reward, such as 1:10; that's just being greedy. Few trades will successfully obtain that high of an r:r ratio, and most trades will probably have turned around before you hit target.



In the chart above, we used the safe entry and stop method, and aimed for a risk/reward target of 1:3. If we had risked $200 on the trade, we would have just collected $600 in profit. If we risked $5000 on the trade, then we would have collected $15, 000 in profit!


Risk/Reward
1:4
Target
Retracement entry
Stop loss


Retracement
stop loss
Entry
Risk/Reward
1:4
Target

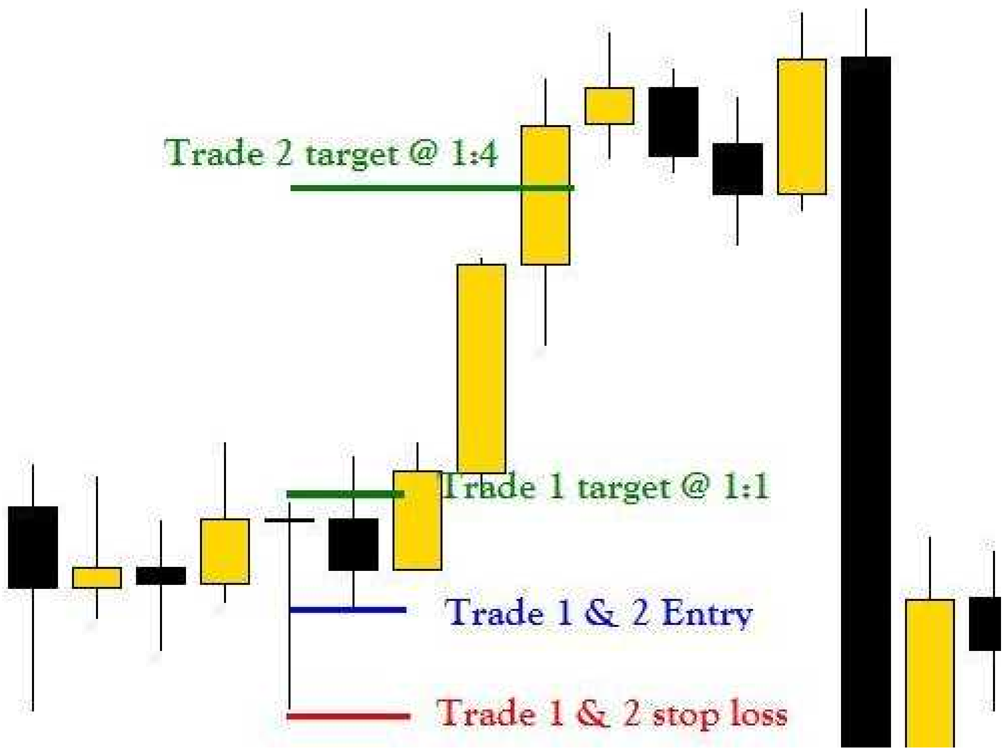
Another approach to this money management system I want to show you is a more conservative/safe tweak that can be added, at the cost of some reward potential.

Instead of opening one trade order, you open two instead, both with the same stop loss and entry prices. The only difference is you split the total amount of money you want to risk on the trade between the two orders. So if you want to risk $200 on the trade, you set the two trades at $100 risk each with your lot sizing.

On one of the trades, set your target for a risk/reward of 1:1

On the other trade, set the target as your original target price for the trade.

When the 1:1 target trade gets hit, you collect $100. This $100 now covers the risk on your second trade which is still open. This makes the second trade a "free trade", because if the second trade was to get stopped out, you would lose no money. First trade was +$100, second trade gets stopped out -$100. The only way you can lose money with this tweak, is if the 1:1 trade does not hit target and both trades get stopped out.



In the example shown above, first our 1:1 target was hit causing the 2nd trade to become a free trade. Now we have peace of mind that we can no longer lose any money from the trade, and allow price to continue on so that trade 2 can hit its target. This tweak will help remove some of the emotional stress involved with trading.

Calculating Lot Size

To apply proper money management to your trading, you're going to need to know how to calculate lot sizes. There are 3 things you need to know to work out your lot sizing.

- The distance between your entry and stoploss in POINTS (not pips)
- How much money you want to risk on the trade
- The 'point value' of each point

($ you want to risk / Stop loss distance in points) / Point value = lot size

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I can tell you that on any pair that is XXX/USD, the **point value is 1.** So if you need to work out lot sizing for pairs like EUR/USD, AUD/USD, GBP/USD, XAU/USD (Gold) the calculation can be done quickly.

$ You want to risk / Stop loss distance in points = lot size

For example; $200/400 points = 0.5 lots

For markets that don't end with /USD, then you need to find the point value. I have an MT4 indicator that provides this value. I would be happy to send it to you if you contacted me via email. Otherwise, you can use a nice easy website tool which does all the hard work for you.

http://www.babypips.com/tools/forex-calculators/positionsize.php

Trading Psychology

Let's talk about a hypothetical scenario, we give two traders the same trading system, and these two traders have the same backgrounds, the same amount of trading experience and the same skillsets. They are both given an identical trading system complete with the same entry, stop placement, exit and identical money management rules. However the difference in results between the two traders can be HUGE, while one trader had a huge increase in profits, the other trader's account is in the negative. How did this happen?

This might sound like a boring subject, but I must stress, this subject must be treated very seriously if you wish to make it in the trading industry. Ever heard that saying 95% of traders fail? The reason for the high failure rate is not because their trading system was bad, it was most likely because they couldn't maintain control over their emotions and allowed bad emotional habits destroy their trading career. You are your own worst enemy in trading!

In the hypothetical scenario above we gave two people identical systems, yet we got completely different results back, the only common denominators left are the traders themselves. The successful trader was able to follow the rules of the system, never breaking them, while the unsuccessful trader was undisciplined, emotional and didn't follow the trading systems rules correctly.

The second you lose your emotional discipline is the second you stop becoming a professional trader and more like a gambler. Traders that 'gamble' their money will have a short life span in the financial markets, we want to be professional traders and that means keeping a cool calm state, having a clear head, trading with a plan and have the ability to accept losses.

Trading Psychology

The typical losing trader will have the following traits…

- Will be following no trading plan, randomizing trade entry/stops/exit on each new position.
- Will have no money management plan, risking whatever feels good at the time.
- Will have wild emotional swings, when trades are in profit they will be happy and in a state of euphoria, when price is moving against them and the trade is negative, they are chewing off their nails from anxiety.
- Will be nervous when trades are open, losing sleep at night.
- Will revenge trade when they get stopped out of a position
- Will never leave the trading screen, watching price tick around all day
- Will never review their performance and try come up with plans to improve performance

If any or all of these points apply to you, don't feel bad, it just means you're like most other traders out there, now you need to step outside this generic thought process and start thinking like the professionals do. The problem with most new traders is they are following their internal intuition when making trading decisions, this is actually a big killer and they don't even realize it. So let's have a look and see why following your own natural instinctive feelings that have been hard wired into our minds, will kill our trading accounts.

The standard way of thinking works against us as a trader

You are in a trade, let's say it is a price action trade based off this course, all off a sudden the trade starts moving against you. What is your natural internal instinct going to be driving you to do? It is most likely urging you to get out of that trade, because it is moving against you and the trade figures are in the negative. So you panic and exit the trade at a loss, only to find out moments later the market turned around and moves in the direction which you were originally trading in. You missed out, all because you listened that natural human instinct which made you emotional. Your trading plan tells you to set your stop loss and let the market take care of the rest, because of your intervention, you've suffered an unnecessary loss and removed yourself the chance of making good returns.

Let's think about another trade scenario, you've entered a trade and everything is looking great, you're up in profit with your exit target set. The trade starts moving against you, you watch the trade start dropping in profit, what does your internal human instinct tell you to do? "Get out of this trade while it is still in profit". So you listen to your internal instinct and exit the trade to lock in the profits you have made so far. As soon as you're out of the trade the market turns back around and continues to move along to hit your original target of 1:3, but because you pulled out while the trade was at only 50% profit, you've missed out on the chance to exit at your original entry of 300% profit.

Another example, a new trader spots 5 setups across 5 different markets, his internal instinct tells him to enter every single trade, because the more positions he enters, the more chance he has of winning overall. Uh oh, the 5 setups that this trader took were across 5 heavily correlated markets and they all moved against him, stopping all 5 trades out and the account takes a massive hit. If he was just to pick the best setup out of the 5, he wouldn't have suffered such a huge loss.

The point is as a trader, everything your natural intuition tells you to do is most likely wrong. It is the traders that take the counter intuitive approach to trading who end up being successful over all. So when new traders step on to the scene, what approach do you think they are most likely to take? You can see why 95% of new traders fail, they take the intuitive approach to trading and listen to their natural gut feeling when making trading decisions, while all the profitable traders are doing the exact opposite!

The best way to solve this problem is to create a trading plan, a trading plan will define rules that you can strictly stick to every time you trade, so you don't end up cutting trades just because they're in a bit of a loss or exit trades early and hinder potential profits. Create a trading plan with defined entry methods, stop placement and exit rules, stick to them as if your life depended on it.

Entry Conditions

How are you going to enter trades? Are you going to enter via the retracement entry or are you going to enter via the breaks of the highs or lows, or maybe you are going to just enter at market when you see the signal. If you don't like large stop losses then the retracement entry method might be the entry rule you set for yourself. Maybe you don't want to miss out on any moves so you set your entry rules to enter at market. Choose whatever method suits your personality so that you are satisfied with every trade entry and there is no urge to intervene and do something irrational.

Trading Psychology

Stop loss placement

Where are you going to place your stop loss? Are you a person that likes to play it safe and always place your stop at the other side of the trade setup, so you completely cover your risk of the setup?, or are going to wait for a breakout and set your stop under the low or high price made for the day? Make the plan suit you, if you don't like really wide stop losses then use the stop behind the high or low of the day for example, or possibly under a retracement level. If you don't mind the wide stops then you can set your rules to place stops on the other side of the setup, so you know that you have the whole risk of the setup defined. Everyone is different, make yourself comfortable with your stop placement so when your stop loss is placed you don't fiddle with it, freak out and move stops to break even too early etc.

Trade target

What risk/reward are you going for? Are you going to aim for 1:2 so your time in the market is relatively short?, or maybe aim a bit more longer term and go for the 1:4 targets? If you aren't really that long term trader and want to be in and out relatively quickly, then the 1:2 targets might be more desirable to you, set targets you are comfortable with so you don't get that urge to exit trades early and remove yourself from potential profits.

Risk Tolerance

How much money are you going to risk per trade? What is going to be your maximum allowed open trades? What about maximum risk exposure to your capital?

When setting your money management rules, make sure you set your rules to only risk what you are comfortable losing, if you risk too much then you won't be able to sleep at night and have a high risk of emotionally intervening on your trade. So if you are comfortable with risking 2% of your capital then apply this to your trading plan rules, if that is too much set the rules to 1%, if you want to trade with more risk set to 3% and so on.

What about total account exposure, if you have 2 trades open at 2% risk per trade, which means there is a total of 4% risk exposure to your trading capital. Again set this to what you are comfortable with, if you don't want to expose more than 5% of your account at any given time, opening another trade at 2% risk would break these rules. Always think worst case scenario, what is the maximum % of your account you are willing to lose? Your rules may only allow you to have 1 trade open at a time, there is nothing wrong with that, your risk tolerance could allow you to have 2 trades open at once. Setting this rule will allow you to keep yourself from overtrading, over exposing your trading account and avoid unnecessary drawdown spikes that most traders suffer from when they overtrade.

Trading Psychology

Once you have put a trading plan together which defines your risk, clear entry points, exit targets and stop placements that you are comfortable trading with, you will have a better chance of keeping out the natural internal human response that kills most trader's chance of becoming successful. Just make sure you stick to your own rules, the second you start breaking your own rules is the first sign you are losing emotional control and you are in danger of being one of them 95% of traders who get washed out from failure. If you find yourself breaking your trading plan, take a step back and think about all the failed traders out there that went down this same path of trading with no trading plan. Don't be one of them, be one of the 5% which make it.

Greed

Greed is probably the most common emotional account killer for the average trader, greed drives us to do things we know we shouldn't be doing, but we do it anyway, just for that chance to catch that lucky break. Unfortunately greed will hurt your account severely rather than give you high returns that you were reaching out for. A good example is a trader watching the charts as a really strong up move is taking place, so the trader enters the market even when his trading plan tells him not to. The greedy trader soon finds out that he entered at the top of a move and the market turns around to quickly stop him out. Another typical case is a trader risking way more on a trade than he should , thinking this will be the trade that gives huge returns, instead the trade fails and all is left is a massive dent in the account. Being greedy will convert a trader into a gambler, we all know what happens down at the Casino, overall the gamblers lose money and walk away with nothing and the Casino is the winner in the end. Don't expect any less from gambling with greed in the financial markets, if you're greedy the market will take your hard earned money.

The best way to keep greed in check is to create a trading plan and follow it with military precision. If your trading plan doesn't tell you to enter the market, don't try and force a trade, wait for the next candle. The market isn't going anywhere, it will be there tomorrow and the day after that, so wait for a valid trading signal and enter with the rules set by your trading plan. When there is a valid trade, make sure you follow your money management plan, don't over risk your account because this will set off an emotional wave that could lead you to do silly things, not to mention if the trade doesn't work out then you have lost more than you should have.

Trading Psychology

Fear

Fear is the opposite of greed, fear of losing one's money. Money is important, nobody really wants to lose their money they worked hard for right? Forex needs to be treated like a business, and most business owners know you can't run a business without losses, that's just the way businesses works. Fear will stop people entering valid trades, maybe because their last trade failed and they don't want to go through that pain again so they sit the trade out, but then the trade they didn't take ends up being a huge success.

Don't let fear hinder with your trading decisions, you need to overcome the fear of losing so you can trade with a clear mind. If you're fearful that your trading system doesn't work, then go back to a demo account or even back test the trading system to help you build the confidence you need to trade with it. Always stick to your plan, don't exit trades early out of fear, set your stop loss and let the market take care of the rest. Don't sit there and watch the charts tick around all day, set your trade up and walk away from it, this will help prevent any emotional intervention on your part.

Just remember you are not a bad trader if you lose a trade, even big time professional market players have losing trades, but their winning trades will out perform all of their losing trades, so when applying money management to your trading plan, make sure your targets are always at least 2x greater than what you are risking. This way you can have more losing trades but overall you can be in profit.

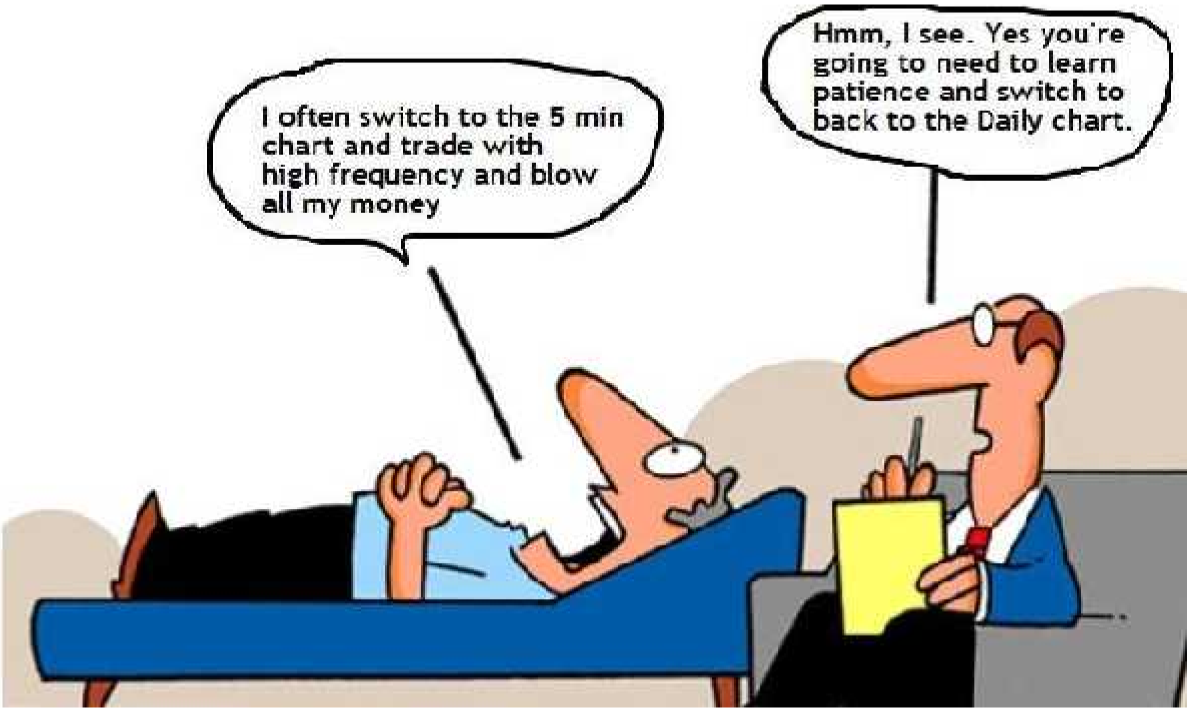
Overtrading

Overtrading falls under a category of greed, the typical trader will use the following logic; 'the more trades I enter, the higher the chance the majority of these trades will hit target and I'll win big'. Unfortunately this type of thought process is far from true and often over exposes the traders account capital to huge risk. Let's say most or all of the trades fail and the trader is stopped out on all the positions he had open. That is going to leave a huge mark on the account which shouldn't have really happened in the first place.

Overtrading (Continued)

Control the amount of account exposure by following your money management plan rules. You must always think worst case scenario, when you enter a trade assume you have already lost that money. If your money management plan tells you not to expose more than 4% then don't overstep that line. If you start exposing more than you should, you're going to lose sleep at night, stressing about trades that have an increased amount of risk weighing on them.

Let's think about it this way, if wanted to increase your account by 20% per month (which is a very healthy figure), that breaks down to 5% increase per week. If you are risking 2% of your capital per trade and aiming for a 1:3 risk/return, then you only need 1 trade per week to hit target. If you had a single successful 1:3 each week, that will be a 24% increase for the month, a figure most traders dream of reaching, all by just placing <u>one trade per week</u>. This throws the idea of 'the more trades I take the more money I will make' theory right out the window. There is no need to trade with high frequency, it requires more work, it's more stressful and not very profitable in the long term.



Revenge Trading

Ever been stopped out of a trade that you were so sure was a perfect setup and then got angry at the market for it? You plan to get your money back that you just lost, so you desperately scan the market for another trade, even if there is no trade you force one out of the market anyway. Because you are filled with rage from your loss and you want to show the market who really is boss, you risk 2 to 3 times more than you normally should. The trade moves against you and you get stopped out of the market again, now your initial loss has just been tripled! Filled with even more emotional rage, you proceed to force another trade from the market to make up for a massive loss, increasing your risk exponentially. This sadly leads to a downward spiral, which unfortunately in the end becomes a margin call. This is what revenge trading is, getting your revenge on the market for a loss, but when you revenge trade the market will take more and more of your money and you will just continue to keep shooting yourself in the foot.

As hard as it is, you must do everything you possibly can to refrain yourself from succumbing to these emotional responses. Everybody goes through the emotional rollercoaster when learning to trade, only the traders that discipline themselves and learn from their emotional mistakes will be the successful in the end.

To overcome revenge trading you must simply first learn to deal with a loss, every single trader has to deal with losses, no one wins 100% of their trades. I have heard stories of professional traders losing 9/10 of their trades, but it is that 1 out of 10 trades they really capitalize on. When you place a trade you must assume that you've lost that money already, this line of thought process will prepare you for the worst case scenario of you getting stopped out. You already assumed the money was gone when you placed the trade, so there should be less emotional damage if you do actually lose it. Thinking like this will also help you keep your risk tolerance in check, it will allow you to only risk money that you are comfortable with losing, this is important because it keeps your stress levels down and you can sleep easy at night when trades are open.

It is important that you set yourself some rules to stop yourself from trying to get revenge on the market after a loss, for example, only allow yourself a certain % of capital loss for the day, if you exceed that percentage, you are to close your trading terminal and seize trading until the next day, if you start to trade over your set limit you know straight away that you are revenge trading! You could also just simply set yourself a rule where you are only take 1 trade per day. I've even heard of traders topping up their account with the equivalent of trade they just lost, this way they don't 'see' the loss on the account balance and this helps them continue to trade in a cool collected state.

Don't ignore revenge trading, it must be address quickly. Find whatever method works for you, so you can prevent yourself from becoming frustrated with the market and destroying your account.

Trading Psychology

Patience

Now you can understand how getting emotions mixing up with trading is a certain recipe for failure, be sure to take the steps to make sure you are in the right mindset before you begin trading with your money. Nobody becomes emotionally disciplined with their trading overnight, it will become a journey that every person must endure before they find themselves discipline enough to reach a state of mind that becomes their trading zone. Open a demo account and treat it as if it was your own money, make mistakes and learn from them, don't make mistakes and continue repeating them over and over. Create a trading plan, set yourself rules and do not break them, if you can't trade by your own rules on the demo account then you are not ready to trade with real money.

If you're impatient with the market it will continue to take your money until you learn to be patient with it. All of the chart examples in this course are from the Daily time frame or higher. The Daily charts are my personal favourite time frame to trade off; big time money makers in forex don't make money scalping the 5 min charts all day. No, they trade longer-term positions that bring in large profits, but this doesn't happen overnight; they will hold trades for weeks, maybe even months. The more patience you have with the market, the more successful you will become over all. If you are addicted to the small timeframes and enjoy the 'rush' of quick in-and-out trading then you are too emotional and are going to have one very hard time making money. If you had 1 million dollars to trade with, would you throw it around on the small timeframes, or would you position yourself on the daily and ride trends?

Trading is not a get rich quick overnight solution, trading is a business so you must treat it like one. There is no reason why you cannot have excellent returns, but you're not going to get them trading greedy, being afraid to enter valid setups, taking on too many positions or getting angry and trying to get revenge on the market after one loss. Be patient, only enter A++ setups, and remember we only really need 1 successful 1:3 trade per week to make good returns for the month. Set up your trading plan, set up rules for yourself and stick to them no matter what!

A final note

We hope that this PDF has changed the way you view the charts forever. Hopefully you're filled with excitement and ready to put what you have learned to use. Remember to only trade on a demo account until you get the hang of it, you may need to go over this material a couple of times before it sinks in well, it's a lot to take in after one go!

We would love to hear back from you! Tell us what you thought about it all, or if you have any questions about this material, or even questions about current charts, please don't hesitate to contact us, we look forward to it!

We will be posting our view of the charts via Facebook and Twitter, so don't forget to add us!

We look forward to hearing from you soon!

- Graham Blackmore
- Pearce 'Scotch' Dunford

www.ForexWinners.net

Website: www.dnbpriceaction.com

Contact Email: support@dnbpriceaction.com