www.forextrendy.com

CFTC required disclaimer: 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.

CFTC RULE 4.41 - Hypothetical performance results have many inherent limitations. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk. Variables such as the ability to adhere to a particular trading program in spite of trading losses as well as maintaining adequate liquidity are material points which can adversely affect actual real trading results.

Content

Introduction

This report was written to illuminate the top misunderstood Forex areas and help Forex traders succeed and stay profitable. The information is presented in a readable way for beginners as well as advanced traders that want to tune up their trading approach and increase their success rate. You will learn by stressing the common mistakes and often revealing obvious but underestimated trading techniques.

Most traders start by asking the correct question: "What's the current market trend?", but then most of them fail to determine the trend correctly and almost all traders miss the next important question: "How reliable is the current trend?"

If you don't take the trend into account, you will often be tricked into placing low winning-probability trades. Trend is your friend. By following the trend it can only be better. But you have to distinguish between the *real* trend and very tempting price action that wants to play with your emotions.

You will also understand the basic principles behind chart patterns, how to draw strong trend lines, how to recognize the patterns and how to trade them. We always keep trading simple and therefore we focus only on the most reliable chart patterns. With the following knowledge, you will be able to spot the patterns leading to explosive price movements and then trade profitably with it.

Enjoy!

Overview

We will cover two different but close areas that all successful traders have mastered:

Section 1 – Trends

- The "buy and hold" strategy is dead today. Do market trends exist?
- The common approach in all trend following systems
- True story: a simple trading system that made a fortune for one famous trader and his investors
- One "trick" that will make the difference between losing (or breaking-even) and winning
- The common mistake: seemingly "strong uptrend" is followed by a hard fall
- How to identify the real trend using pure price action
- Which trend is more reliable and how to compute the trend reliability
- Another common mistake: Stop Loss not reflecting the current market volatility
- Which markets to avoid and how reliable trends increase success rate

Section 2 – Patterns

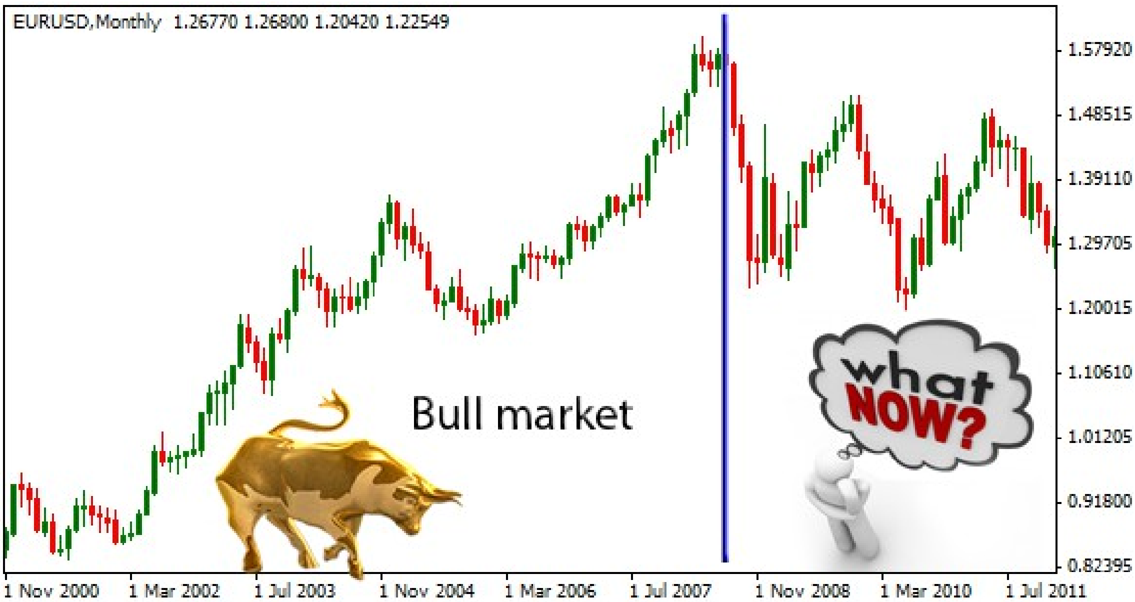
- The guidelines to drawing good trend lines. Breaking through a strong trend line results in a massive and profitable move.
- Several examples of good and bad trend lines and the common mistakes
- "Time bombs" constructed by trend lines
- The definite strategy to enter an order, place your Stop Loss and taking a profit
- Using the "Projection Method" to determine the "Take Profit" Point
- Intelligent software that can recognize strong trend lines and chart patterns

Section 1 – Trends

The myth of market trend

Trend following has been the best style of trading for the past 30 years. There were times when traders made fortunes just by following the trend or following a simple system based on two moving averages crossover. The "buy and hold" strategy that was so popular by traders about a decade ago is dead today.

Look at the EUR/USD chart from January 2001 until July 2008. The uptrend was pretty strong most of the time. If you pushed the "Buy" button, you would win most of the time even with a poor trading system. The consistent rise of the euro over the dollar was giving you a clear sense of the overall trend.



Since July 2008, it looks like everything has changed. The trend direction is unclear, nobody knows what is going to happen next and people are seriously preparing for the coming collapse of the single European currency. By the way, for us (Forex traders) it would be nothing but another opportunity to make a profit, so keep smiling.

Does it all mean that markets are not trending today? Of course they are trending! Trends exist and they can be traded up and down for profit. There will always be short-term trends in any market, the only question is when! So, the big question is…"how do we find the best trending market and not miss the opportunity of taking trading signals in the direction of a strong trend?" You will find a definite answer soon.

The belief that trend following is an outdated trading technique is only partially true. It is true that there is hardly any market with clear overall trend direction. You could follow the temporary trend **only if you are able to determine the trend correctly**. This is the point where so many traders fail. A pair moving up on a 30-minute time frame can act exactly contrary on an hourly time-frame. Even if you find a rare coincidence **–** a currency pair moving in the same direction on all time frames **–** you still need to know "**how well" the market is trending** to avoid very short-term trends. The solution is smart and simple.

How to increase the profitability of any system

Before you discover the most simple and effective method to determine the trend, let's see what it's good for. All the trend following systems are based on one common approach:

"Buy the dips in an uptrend and sell the rallies in a downtrend."

Let's reveal one simple trading system that actually made a fortune for one famous trader and his investors. The system "Donchian 5 & 20" is named after him. Here is the set-up.

In the chart above, you see two indicators – the blue line and the red line. The blue line is the indicator *SMA 5* (stands for *simple moving average* with period 5) and the red line is *SMA 20* (*simple moving average* with period 20). Donchian's idea was very simple:

1. **Buy when the blue line crosses the red line upwards**
2. **Sell when the blue line crosses the red line downwards**

Even a 5-year old child could do this! Actually, there is nothing special about this system. All trend following systems are like this. Some systems are more advanced, with more sophisticated indicators, but the common approach is to *buy the dips and sell the rallies*.

If everyone could do this, then what's the money making secret?

The answer is that Donchian used this system in strong bull markets. Yes, *trending* markets! This important note is the key to consistent profits as illustrated in the chart below.

The first trade was profitable because it was made in the direction of the strong trend. The next trades lead to losses as the market was turning up and down without a clear direction. Profits made in the first trade would be taken back in a series of losses.

How Donchian dealt with it was smart. He ignored all trading signals when the red line was not going up on at least a 45 degree angle. He wouldn't take any losing trades after the first trade because the red line is not trending at all. It is in a so called *choppy zone*. So why was Donchian able to make a fortune from such a simple system while others could not? Because others would throw this system away as not profitable! The only "trick" was to follow a good trend and not taking any other trades.

What is the lesson from this story?

If you know how to determine the market trend correctly, it could make a difference between losing or break-even and winning. Donchian used a simple moving average to determine the trend and filter trading signals.

1. When the market was trending, he turned his system on.
2. When the market was in choppy zone, he turned his system off and ignored any trading signals.

What *you* can do is just the same with any trading system or robot. Determining the trend using a simple moving average can be replaced with a more sophisticated, versatile technique that you will learn in the next pages.

How to determine the trend

Some people learn from their mistakes, but smart people learn from other people's mistakes. So let's start with examples of a wrong but very common approach to market trend analysis.

What you see in this chart is explosive price movement that is usually the result of a news release. All brokers, platforms and various currency tools are indicating a "strong uptrend", tempting people to jump in and make a profit. What happens next is, at best, a choppy zone, or a hard fall.

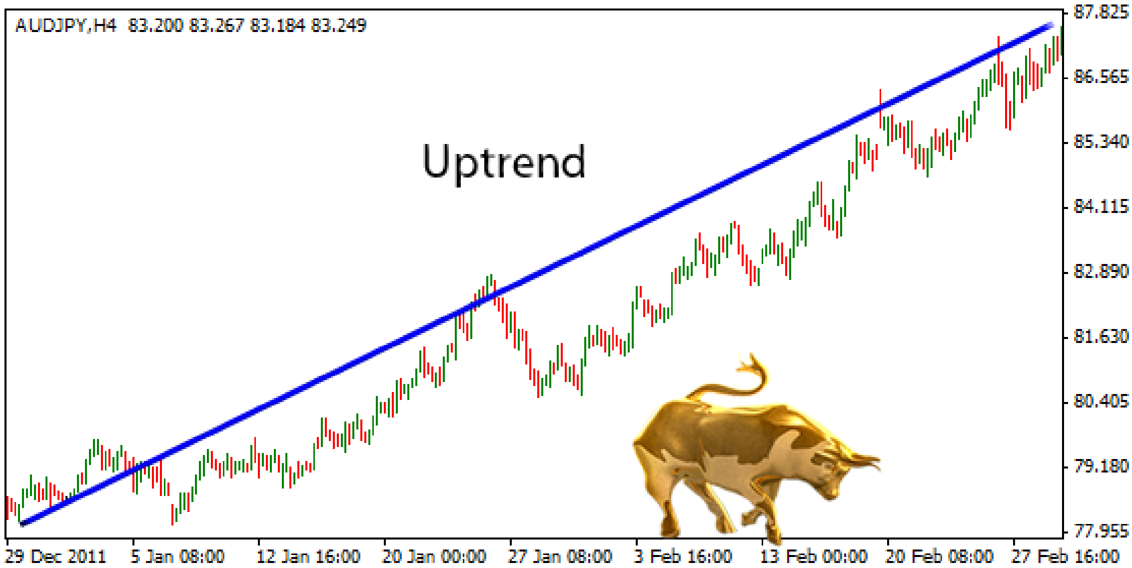
What is actually in the chart are a few consecutive long green candlesticks. This is not a real trend, but immediate price action, tempting traders to initiate trades and experience a costly and painful exercise. To avoid falling into this trap, you need to focus on longer trends. This is what a real trend looks like:

The price is consistently rising with no sudden changes or explosive movements. You can expect that this trend will continue and you should take only bullish signals. Obviously the trend won't last forever and you can even have bad luck by entering the market at the end of the trend, but **the odds work for you**. It simply cannot be better. There are 100s of free or proprietary indicators to identify the trend but believe or not, no indicator is better than the human eye. As Albert Einstein said:

"Make things as simple as possible, but not simpler."

Now let's reveal the easy but the most effective method to identify the trend.

1. Zoom the chart in/out to show about 200 bars. Notice that 200 bars on daily chart (or 200 trading days) correspond to 1 year.
2. Connect the lower left corner with the upper right corner. If the line overlaps with the price bars several times (the more times, the better), you have found a reliable uptrend. See the example below.



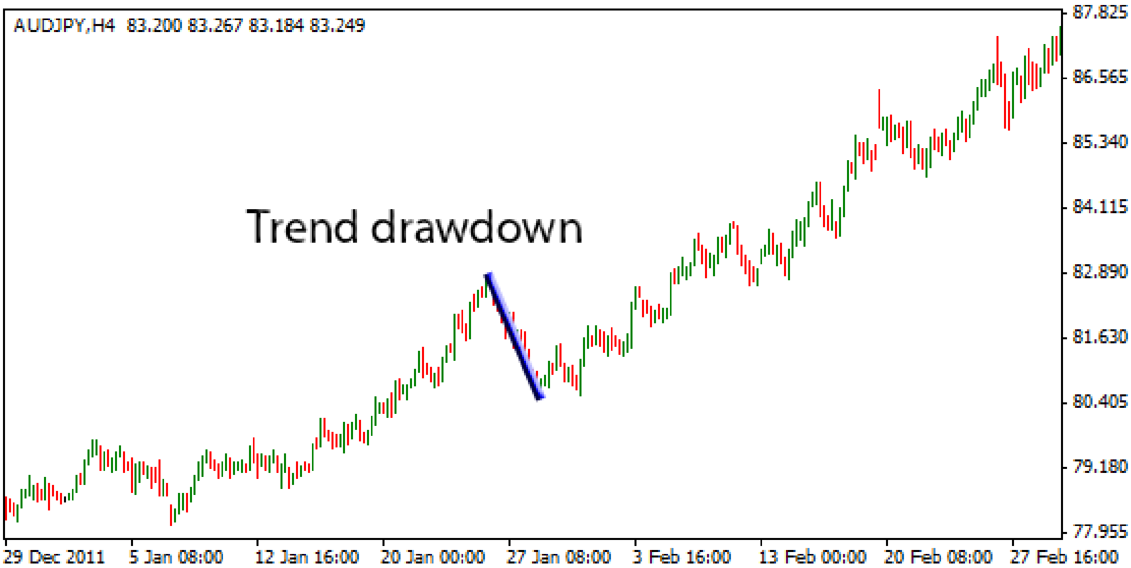
3. Connect the upper left corner with the lower right corner. If the line overlaps with the price bars, you have found a reliable downtrend.

As you see, the market is like a sea wave and it keeps on going up and down. Sometimes the dips are too deep to consider it a reliable uptrend, or the rallies are too high to consider it a reliable downtrend. Knowing the "trend reliability" is the key to discover the **real and reliable trend**. So, how do we determine if the trend is reliable, or whether it is better to stay off? The best way is to forget any lagging indicators, but to use pure price action.

What is a trend drawdown

Trend drawdown is computed from pure price action and so is the best way to determine the trend reliability. It simply tells you how deep the price went against the current trend. You will appreciate this method in the next paragraph "Protecting against volatility".

Now, take a look at the chart below.



The blue line indicates the deepest move against the current trend. In this example it is 233 pips. The whole move in this chart is 882 pips.
The trend drawdown is:

$$233 / 882 = \text{cca } 26\%$$

Not bad. Conservative traders would prefer the trend drawdown to be below 20% as it is more reliable. The 'big dogs' prefer trends with drawdown even below 15%. Such trends exist almost every day in at least one Forex chart. Trends with drawdown below 10% are very rare, but when they appear, they are gold mines – you can easily achieve a winning percentage above 90%.

The lower trend drawdown = the more reliable trend = the greater success rate = the more consistent profit!

One more important note:

How many bars should we use to define the trend? We have used 200 bars in the examples above. It is a compromise – not too much, not too little. If you were to use only 20 bars, you would risk entering the short-term explosive market movements which are not real trends as we have explained above. If you were to use 500 bars, you would hardly find any currency chart with trend drawdown below 20%. Before we show you how to systematically pick the best trending pairs and time frames every day, let's look at how to use the trend drawdown in the most important aspect of trading – using a Stop Loss!

Protecting against volatility

Look at the chart above. The trader who placed the Stop Loss right after entering the market deserves great applause but the problem is, the Stop Loss is too tight! Give the market enough space to breath or the Stop Loss will be hit very quickly.

Some traders use a fixed number of pips, something like 50 pips or 100 pips... this is bad! Stop Loss has to reflect the current market volatility. Ask yourself:

“when did the price go as deep as my Stop Loss?” If it has happened several times in the current chart, why would you think your Stop Loss will not be hit now?

The ideal Stop Loss should be greater than the trend drawdown.

Listen to the market, not to the pips. In the example above, the Stop Loss should be at least 233 pips. Too much? Well, use a smaller lot size. If you trade 1 minilot and $233 is above your risk tolerance, then use microlots. Or don't take the trade. The worst thing you can do is use a small pip value just because you want a small risk. Actually, you would risk more because if you don't give the market enough space to breath, the Stop Loss would likely be hit regardless of how good your trading system (or reliable the trend) is.

You would do well if you would use the trend drawdown + 1 pip as the pip value for the Stop loss (233 + 1 = 234 pips in the example). If you want to increase the success rate but on the other side, increase the risk when compared to the profit potential, your Stop Loss should be set at a much safer 1.5 x trend drawdown.

Stop Loss = 1.5 x trend drawdown = 1.5 x 233 pips = cca 350 pips

Some traders would prefer even 2 x trend drawdown = 466 pips. Such Stop Loss would be safe enough from the wild market. It's all about statistics.

Exercise

Now it's time for a little exercise. Here are two charts with obvious up and down trends.

The maximum drawdown indicated by the blue line starts from the high at 78.66 and ends at the low at 78.18. The trend drawdown in pips is:

78.66 – 78.18 = 0.48 (48 pips)

Now let's calculate the percentage drawdown. The visible uptrend starts from the low at 76.06 and the maximum high is at 79.50.

The overall move in the current chart is:

79.50 – 76.06 = 3.44 (344 pips)

The percentage drawdown is:

48 / 344 = cca 14%

No doubt, the trend with drawdown below 15% is solid. Place the Stop Loss at least 49 pips below the initial entry point.

In the next chart, there is a downtrend.

The trend drawdown in pips is:

1.3065 – 1.2955 = 0.0110 (110 pips)

Now let's calculate the percentage drawdown. The visible downtrend starts from the high at 1.3283 and the maximum low is at 1.2682. The overall move in the current chart is:

1.3283 – 1.2682 = 0.0601 (601 pips)

The percentage drawdown is:

110 / 601 = cca 18%

The trend reliability is moderate. Place the Stop Loss at least 111 pips above the entry point.

The ultimate solution

Discipline and patience are the two key points to succeed in the Forex market.

Stop hunting the market for every potential trade. Prepare before trading. Scanning a few currency pairs on all time frames can take you about 15 minutes, but the consequences are invaluable. Pick only the best trending currency pairs and time frames and ignore all other unpredictable movements.

Trade less, profit more. A few guidelines:

1. **Trade only if the trend drawdown is below 20%**, (preferably below 15%).
2. **If the trend drawdown is below 15%**, you can be consistently profitable even with a simple trading system such as "Donchian 5 & 20" (page 6).
3. **If the trend drawdown is below 10%**, you have found a gold mine! You can simply enter the market in the trend direction with a 90% success rate.

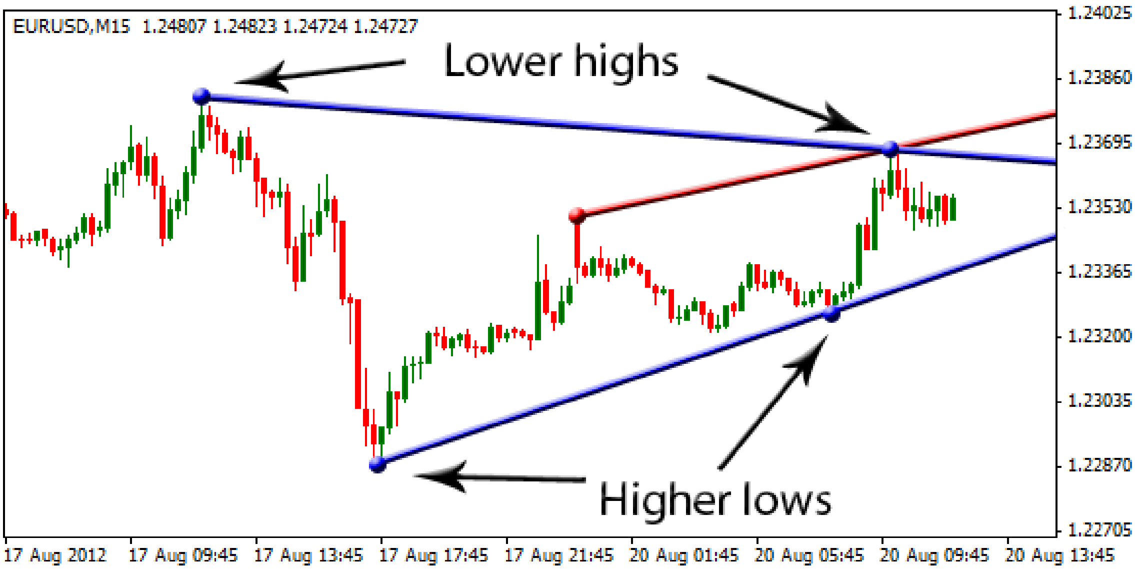
The ***Forex Trendy*** ultimate solution scans 34 Forex pairs on all time frames for you every second. It calculates the trend drawdown for each chart and shows the most reliable trends sorted by reliability based on your preferences.

Click here to watch a video how it works

Section 2 – Patterns

How to draw trend lines

Most traders think that drawing trend lines is all about connecting various highs and lows. Without proper knowledge & experience, you would see them everywhere, however not all trend lines should be considered. If you follow the guidelines to drawing good trend lines, there is a high chance that the price will respect your trend line and get repelled by it, or it will break through the trend line resulting in a massive and profitable move. Let's start with some basics.



1. The **upper trend line** (blue) connects at least two lower highs, so it is sloping down.
2. The **lower trend line** (blue) connects at least two higher lows, so it is sloping up.
3. The red trend line in the chart is a little controversial when it comes to discussion. It is obviously an *upper* trend line (connecting two highs), but it is *sloping up!* Such a trend line alone is **not** valid unless we deal with "Wedges" and "Flags" as you will see in the next pages.

Remember: an upper trend line is sloping down, while a lower trend line is sloping up.

Examples: Good Trend Lines vs. Bad Trend Lines

When the price breaks through a strong trend line, it goes further, offering you a great profit potential. You can draw many trend lines in one single chart, but there are several guidelines to choose only the strongest trend lines:

1. **Prefer trend lines with more than two touching points.** (Trend lines become stronger the more times they are tested).
2. **The touching points should not be too close together.**
3. **Longer trend lines are stronger than shorter trend lines.** Longer trend lines are also seen on the upper time frames, so more traders are aware of them.

In the example above the touching points are very close together forming an unreliable trend line. There is no other touching point on the rest of the trend line.

In the next example below, the two touching points are not so close together, but the trend lines are too short. **A good trend line should be at least 50 bars long**. There exist much better upper and lower trend lines in this chart as shown in the previous page.

Now let's see some good trend lines!

The trend line above has 3 touching points and can be considered as much stronger than trend lines in the previous examples. The points are evenly distributed and the trend line is long enough. All three guidelines are met perfectly.

Now this trend line is a monster! It is long enough with 5 touching points. You may notice that there are two groups of two points that are too close together, but this is not a problem as long as the other points meet the guideline. **Treat a group of close points as one "big point".**

"Triangles, Flags, Wedges..."

Now that you know how to draw trend lines, you are one step away from discovering the oldest market phenomenon: chart patterns. You are about to learn incredibly reliable price formations that have time and time again provided us with consistent profits.

The upper and lower trend lines are forming a **triangle** as seen in the next chart. As the price is oscillating between the two bounding lines, the buyers and sellers are in tug of war, and eventually the price will break through one of the lines – nobody knows which one! In the next pages you will learn how to participate in this explosive move.

Falling wedge is like triangle, but both trend lines slope down. Recall that the bottom line alone would not be a valid trend line. You begin by drawing the upper trend line and then you complete the wedge or triangle (it depends on which line has more touching points).

One important note: **the upper and bottom trend lines must converge so that the price is being squeezed.**

The flag pattern is encompassed by two parallel lines. The price is not squeezed by the trend lines, but it is moving inside the channel formed by the trend lines. **Flags are usually seen as the market pauses after a big move before continuing its main trend.**

All the presented patterns above are in an uptrend. The uptrend does not need to be perfect, the price before the pattern is just rising. Chart patterns after a downtrend are similar. We will focus only on *continuation patterns*, that is, buying in an uptrend and selling in a downtrend. You may hear about *reversal patterns*, but trading against the trend requires a *lot* of experience. Many banks have crashed and many fortunes were lost because of stubborn traders trying to pick the tops and bottoms. Trend is your friend, so keep it simple!

How to trade chart patterns

Now it's time to reveal the definite strategy to enter an order, place your Stop Loss and take a profit, so you don't need to watch the market and you don't let your emotions control your trading.

The best way to enter the market is by using "Stop Orders" and "Limit Orders".

When the orders are placed, they are located on the broker's server, so you can safely leave your trading platform. This brings you freedom from trying to spot the best entry point.

The entry rule is simple:

1. If you trade a pattern in an uptrend, **place a Buy Stop just above the upper trend line.** Where exactly? You may want to place it 5 pips above the trend line to spot the real breakout. The advanced approach is to reflect the market volatility as we will discuss it later.
2. **Place a Stop Loss just below the lower trend line.**
3. If you trade a pattern in a downtrend, you do just the opposite – place a Sell Stop order below the lower trend line and a Stop Loss above the upper trend line. More in the Exercise.

The interesting part is when to Take A Profit. Many traders enter the trade blindly without any idea where to exit! Notice that the Stop Loss below the trend line reflects the current market volatility. It is not (and never should be) a fixed number of pips. The same should hold for the Take Profit. You cannot just decide that 50 pips is enough and you would exit the position. 50 pips is very different on minute time frame and daily time frame.

There are two great methods to find the Take Profit level:

1. **Projection method** – easy
2. **Fibonacci method** – using several Take Profit levels, a little complex, but better

Let's focus on the first one; **The Projection Method**.

1. Measure the greatest width of the pattern.
2. This pip value will be used for the Take Profit.

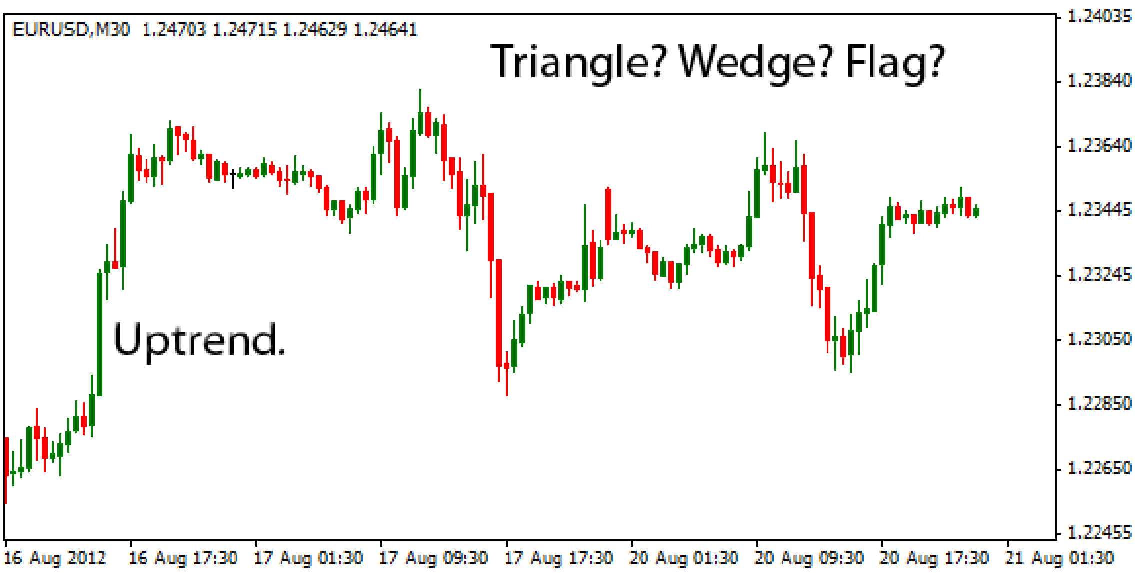
Use the same method for triangles, wedges, flags or single trend lines. As the market breaks from the choppy zone, it normally travels at least the projected distance.

One note about the **flags and wedges;**
As the price travels between the boundary lines, it happens that the trend line is not broken and the pattern becomes deeper, or even no more valid. In such a case cancel the order and place a new one to reflect the current situation. Sometimes the situation is not going as you had planned and the price breaks through the other trend line. Then simply cancel the order and forget the pattern. Rather not taking the trade than taking a bad trade is the key of successful trading. There will be plenty of other opportunities!

Keep in mind that chart patterns can appear and disappear, or morph into another patterns. An *emerging pattern* is not confirmed until the relevant trend line is broken.

Exercise

First, let's look at the clean chart below. There are several significant highs and lows that can be connected with a trend line. Before the choppy zone we see a minor uptrend, so we are going to complete the pattern and place a buy order.



There is just one way to draw the two trend lines that meet the guidelines. These trend lines are forming a triangle pattern.

1. **Place a Buy Stop order just above the upper trend line**.
2. **Place a Stop Loss Order just below the lower trend line.**
3. The distance of the highest high and the lowest low of the pattern is 93 pips, so this is the pip value for the Take Profit.

As the pattern continues to grow, you can replace the Buy Stop order a bit lower to the trend line, but it's not necessary. Finally, the upper trend line is broken, the Buy Stop order is executed and the Take Profit is hit!

Another example:

A minor downtrend is preceding some pattern. The lower trend line is obvious. What about the upper trend line? It's not completely obvious; there are several ways to complete the pattern into triangle, wedge or flag. We would prefer a flag because triangle or wedge would be too wide and the Take Profit would be too far (unless you use a more complex Fibonacci technique for several Take Profit levels).

Now the well-known techniques are made in the opposite direction:

1. Sell Stop order below the lower trend line,
2. Stop Loss above the upper trend line,
3. Projected Take Profit.

The trend line is broken, the Sell Stop order is executed and we make money in a downtrend until the Take Profit is hit. As we use a single Take Profit level, the downtrend continues without us... **let it go!**

Recognizing chart patterns

Professional traders used to analyze chart after chart to find reliable patterns on daily and even intraday time frames. Today, computing power comes into play. ***Forex Trendy*** is a software solution able to recognize chart patterns on all charts every second!

34 Forex pairs x 9 time frames = 306 charts!

It has an intelligent algorithm to recognize strong trend lines and discover the most reliable chart patterns at the current time. You will learn more techniques about chart patterns in the membership subscription:

- Using Fibonacci technique for multiple Take Profit levels
- Trading "pullbacks" by using Limit Orders for a better entry point
- How market volatility is used to filter false breakouts
- And more supertips!

Click here to watch a video about automated chart pattern recognition