



CHINA
KOREA
TAIWAN
Exchange Rates

EUR	35.8	36.1
GBP	45.97	46.1
JPY	0.287	0.291
SGD	22.89	22.99
HKD	4.47	4.50
AUD	27.08	27.36
NZD	24.18	24.32
CHF	27.99	28.32
SEK	4.89	5.03

4 KEYS TO PROFITABLE FOREX TREND TRADING

Unlocking the Profit Potential
of Trending Currency Pairs

Christopher Weaver

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THE 4 KEYS TO PROFITABLE FOREX TREND TRADING

UNLOCKING THE PROFIT POTENTIAL OF TRENDING CURRENCY PAIRS

By Christopher Weaver

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HARRIMAN HOUSE LTD
3A Penns Road
Petersfield
Hampshire
GU32 2EW
GREAT BRITAIN

Tel: +44 (0)1730 233870
Fax: +44 (0)1730 233880
Email: enquiries@harriman-house.com
Website: www.harriman-house.com

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PREFACE

What this book covers

This book covers four different approaches to trend trade the foreign exchange market. These four keys are:

1. Trend lines
2. Channels
3. Fibonacci retracements
4. Symmetrical triangles

We will explore the primary strength of each key, why it is useful, and the different variations of each key. We will then go through two practical strategies for each key and how to use them to execute successful trades.

It is worth noting that all of the strategies in this book can be described as continuation strategies. A continuation strategy is one that is traded in the direction of the trend on the assumption that the trend will continue.

As these keys are general concepts in technical analysis they are not limited to specific currency pairs. For example, one can trade using a trend line for a minor cross currency pair such as the GBP/AUD, with the same confidence as when trading a major currency pair such as the EUR/USD.

These keys and their corresponding strategies are designed to be traded in the foreign exchange spot market. But they are equally applicable to trading CFDs or spread betting.

Who this book is for

As this book does not cover such basics as general trading terminology, the process of placing a trade or navigating through a trading software package, it is assumed the reader is comfortable with trading in general and is therefore looking to enhance their overall trading experience by generating more profit. The application of the techniques in this book should be possible with any standard charting package.

Notes on charts

All the charts in this book were produced using © eSignal.

INTRODUCTION

The currency pairs which make up the foreign exchange market provide us with some of the most reliable trading trends. This is due to the high daily liquidity, or volume, of the market. The foreign exchange (forex) market as a whole trades around US\$4 trillion every day - far more than all of the major stock markets in the world combined. All of this trading creates strong trends!

For instance, look at the EUR/USD currency pair.

Figure 0.1: major trends in EUR/USD



Of all of the currency pairs that make up the forex market, none is traded as heavily as this one. This means that whatever direction this currency pair is moving in, there is a huge amount of money backing it. It is believed that there is nearly US\$1 trillion of trading volume per day on this currency alone. If it is trending up, it will require something dramatic to sufficiently turn the sentiment of the buyers into sellers and shift the trend.

Compare that to an obscure stock listed on a minor stock exchange. The smallest bit of news regarding the company, or the change of opinion by just a handful of stock holders, can turn an uptrend into a downtrend very quickly.

Liquidity is the key in providing reliability for trend trading - this is good news for the forex trend trader.

KEY 1

TREND LINES

A trend line is one of the most commonly used tools in technical analysis. However, while most traders know what this tool is, not so many know how to use it to implement an effective trading strategy. More often than not, traders draw a single trend line, which is used to highlight historic price action rather than to project a probable future.

Because of this, the trend line has come to play a minor role for many traders in setting market entries and exits. People have overlooked the simplicity of the trend line in favour of more complex indicators and systems. This is a shame as they are missing out on a powerful tool.

In this chapter, I am going to explain trend lines by defining their characteristics, by discussing different types of trend lines, and showing how they can be used to project future trading zones. We will also look at the power of using trend lines to pinpoint exact entry and exit prices.

THE THEORY

Primary strength: tells you whether to buy or to sell

A trend line shows which way the currency pair is trending and reveals the current market sentiment of the pair. The market sentiment is revealed by the direction of the trend line. If the trend line is moving up, then the market feels that the base currency (the first currency in the pair) is stronger than the terms currency (the second currency in the pair).

If the pair is trending up then we are likely to buy, if it is trending down then we are likely to sell. Knowing this up front, before considering the entry and exit points of the potential trade, puts you in a good position to effectively analyze a particular currency pair. Once your trend line is drawn and you are sure about your intention to either buy or to sell, you can move on with confidence and begin looking for possible places of entry into a position.

Another important benefit of trend lines is that they allow us to spot key turning points in the price action. A key turning point is a moment where the price action changes direction, forming either a peak or a trough. As we will see in this chapter, identifying these turning points creates effective entries in the market.

Some practicalities

In this book the price action, which is the plotted history of the exchange rate fluctuations, is shown by using candlesticks. The most basic of charting software will have a trend line option that can be used to highlight trend lines when they occur.

While it is true that each chart can present many different trend lines and can therefore be highly subjective, the goal for the trader is to identify the most obvious one. This is because our trading decisions must be based on information that the larger market moving traders, such as banks and large funds, are considering. The more eyes that see these trend lines, the more trading that takes place based on them and the more this happens the more likely they are to cause the desired reaction to the price action.

Trend lines can be drawn on any time frame. In this book, however, the shortest time frame chart we consider is the 15 minute chart and the longest is the daily chart. This is because trend lines drawn on anything less than the 15 minute chart tend to breakdown too often and are therefore unreliable to trade with. While charts longer-term than daily do not produce enough trading opportunities and can become outdated. The effect of being able to draw trend lines on a number of different time frames is that the amount of potential trading opportunities is very large.

Basic trend line characteristics

A trend line has two major characteristics,

1. it has a **minimum of three touches** with the price action, and
2. it is **angled** and not horizontal.

The requirement for three touches is a generally accepted rule in technical analysis. Two touches are more likely to be just a coincidence. With that in mind, the more touches there are the stronger the trend line.

The trend lines in the following charts demonstrate both of the required characteristics.

Figure 1.1: example of a simple, single-sided trend line



Figure 1.2: example of a simple, single-sided trend line



After examining the previous charts, you should be able to recognize how the presence of a clear and established trend line can enhance your trading profitability. When a trend line is pointing up, as it is in Figure 1.1, you will be considering long entries; when a trend line is pointing down, as it is in Figure 1.2, you will be considering short entries. To do anything else would be trading against the trend, and is likely to decrease your probability of success.

Later in this chapter we will identify which significant points on the chart provide you with the most efficient entry in relation to the trend line. Before we do that, there are a few more concepts regarding trend lines which you need to understand.

Trend line types

The basic trend line shown in Figure 1.2 is a simple concept which people generally find easy to identify. This basic approach, however, is insufficient, leaving you wondering how far back on the chart to go in search of trend lines and which trend line to use if you identify more than one.

Answering these questions is a matter of understanding the difference between major and minor trend lines, the impact that key moving averages have on trend lines and differentiating between the single-sided trend line and the double-sided trend line. The following sections of this chapter will do just that.

Single-sided trend lines

A single-sided trend line (like those in the previous figures) are called *single-sided* because the price action is only on one side of the trend line.

- If the price action is **going up**, the trend line is *beneath* it. One can think of the trend line as holding up the price action.
- If the price action is **going down**, the trend line is *above* it. One can think of the trend line as pushing down the price action.

Take a look at Figures 1.1 and 1.2 again, viewing them with this understanding of single-sided trend lines.

Double-sided trend lines

A double-sided trend line always runs through the price action, as opposed to running on just one side of it. The result is that there will be price action on either side of the trend line. A single-sided trend line connects only troughs or peaks depending on its direction, but a double-sided trend line connects both peaks and troughs. As with single-sided trend lines, the double-sided trend line must have three touches with the price action.

One problem that can occur with introducing the double-sided trend line to our analysis is that suddenly we can identify many trend lines. To address this we must understand two points:

1. The more touches the price action has with the trend line the more relevant the trend line is.
2. The most obvious trend line is the one to use. This is for the same reason as previously mentioned concerning single-sided trend lines – we want to use the trend lines that the majority of the market is also using.

Look at the following chart of the EUR/USD daily chart for the nine month period between March 2009 and November 2009.

Figure 1.3: example of a double-sided trend line



You can see that the overall trend for this time period is definitely up, but the price action jumps from one side of the trend line to the other. This is typical of longer-period trend lines, especially when viewed on the daily chart.

Let's look at another double-sided trend line. The following chart is the USD/JPY for the 18 month period between July 2008 and January 2010. The trend in this case is down.

Figure 1.4: example of a double-sided trend line



Although the overall trend is down, you will notice that between March 2009 and December 2009 the price action is bouncing off the top of the downward trend line. This is not a problem. Remember we are now considering more complex trend lines and the interaction which the price action has with them. In this example, the downward trend is further confirmed by the presence of another downward trend line. The following image reveals the second trend line and unveils more recent price action for the same currency pair.

Figure 1.5: example of multiple double-sided trend lines



The direction of these two trend lines conveys the message of a very strong downward trend. From this chart we know that short setups are the only trades that we should be looking for. Long positions are completely out of the question. That is the discipline of trend trading - recognising the trend and trading with it.

Figure 1.6 is the daily chart of the AUD/CHF for the 12 month period from April 2009 to April 2010. It is another example of a double-sided trend line.

Figure 1.6: example of a double-sided trend line



Notice the clarity that the trend line brings to the chart. You should be beginning to realize the power of trend lines and the way that they can be used to determine meaningful turning points within the price action. Think of the price action as being drawn towards the trend line and then pushed away from it.

Double-sided trend lines are normally more difficult to spot than single-sided trend lines. This is because the trend line is normally running through the middle of the price action, making it more difficult for the eye to discern.

A good way to discover these trend lines, however, is to use your charting software to project rays from significant peaks and troughs. Keep projecting these rays until you find the line that has the most touches with the price action over the longest period of time. Although this approach may sound like a fairly random way of doing things, you will be able to appreciate just how effective it is once you've tried it.

Double-sided trend lines normally occur when dealing with larger time frames such as months, or even years. This is because it is very difficult for the market to trade on, or to keep to, just one side of a trend line for an extended period of time. Remember that with double-sided trend lines it is the angle of the trend line that determines the direction of the trend, not the side of the trend line which the price is bouncing off.

Now that you understand the difference between single and double-sided trend lines, we can explore the concept of major and minor trend lines.

Major trend lines

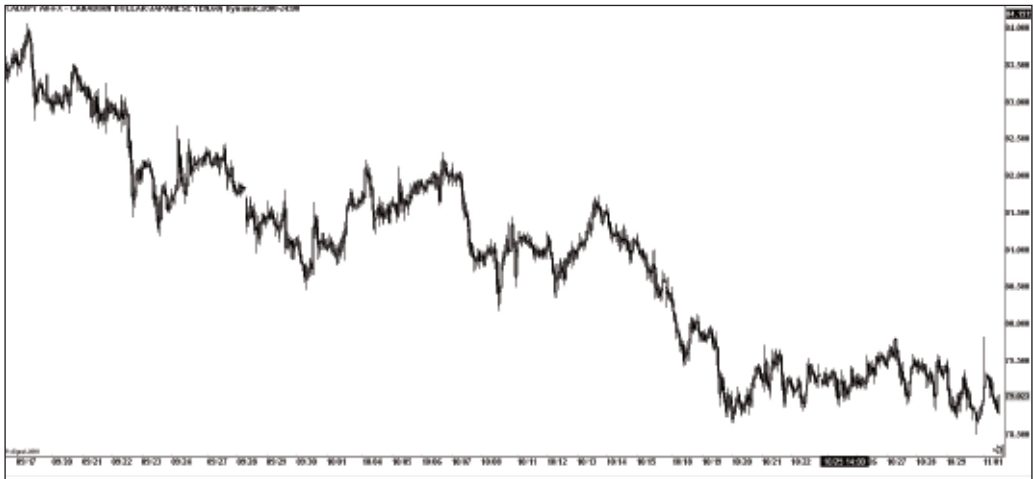
In order to trend trade effectively you must understand the difference between a major trend line and a minor trend line. Note that both major and minor trend lines can be either single or double-sided.

A major trend line is defined as the primary trend line that is consistent with the *visual flow* of the chart. It is used to determine whether to trade a long or a short position.

When looking to spot the major trend line on a chart, you need to know if the price action is moving up or down. You can usually tell by a quick glance at the chart.

For example, look at the following 60 minute CAD/JPY chart and ask yourself whether the price action is moving up or down.

Figure 1.7: example of a downward moving currency pair



The obvious answer is that the price action is moving down. This is what is meant by analysing the *visual flow* of the chart.

Major trend lines are always in line with the dominant market push. Identifying the *visual flow* keeps your trading within the realm of common sense and cuts out over-analysis.

Next, draw the most obvious downward trend line that you can find. In this case, there are two trend lines worth considering. The first one is a single-sided trend line with three touches as shown in Figure 1.8.

Figure 1.8: example of a single-sided trend line



As you can see in the following chart, the second trend line is a double-sided trend line which has ten touches with the price action.

Figure 1.9: example of a double-sided trend line



From this analysis we come to the conclusion that the major trend line for this particular chart is the double-sided trend line, which has more than three times the number of interactions with the price action than the single-sided trend line does. It is, therefore, this trend line that can be used to identify key turning points for the currency pair.

To summarise, the major trend line is the line which is congruent with the *visual flow* of the chart and has the most touches with the price action. If a trend is present, then the chart will have just one major trend line.

Minor trend lines

Minor trend lines are trend lines which either run counter to the *visual flow* of the chart or follow the *visual flow* but have fewer touches with the price action than the major trend line. While there can be only one major trend line, there can be several minor trend lines.

Using the example of the CAD/JPY 60 minute chart shown in Figure 1.7, you can see that the single-sided trend line which we considered first is a perfect example of a minor trend line. Although it is consistent with the *visual flow* of the chart, which is down, it has fewer touches with the price action than the major trend line. This does not mean that this single-sided trend line should be forgotten; it should simply be recognized as a minor trend line. It certainly holds value, as far as our trading opportunities are concerned, though not as much value as the major trend line.

If you refer back to the earlier images of the USD/JPY daily chart, you will find two trend lines there. One is a major trend line, while the other is a minor trend line. Both were valuable.

Make sure that you plot both the major and minor trend lines on your chart together, as shown in Figure 1.10.

Figure 1.10: example of a double and single-sided trend line on the same chart



This is a good example of major and minor trend lines bringing clarity to a currency chart and adding a certain level of discipline to your trading. Later in this chapter we will explore the price zones that major and minor trend lines create.

As we discussed, minor trend lines can either go along with, or counter to, the *visual flow* of the chart. The first minor trend line which we looked at was consistent with the downward move. It was only considered minor because it had fewer touches with the price

action than the major trend line. Now we are going to look at a minor trend line which is counter to the *visual flow* of a chart, known as a *minor counter trend line*.

Looking at the Figure 1.11, I have indicated where these minor counter trend lines have formed.

Figure 1.11: example of double and single-sided trend lines with minor counter trend lines



Notice that, as far as time is concerned, these minor counter trend lines have a much shorter life than either the major trend line or the minor trend line consistent with the *visual flow* of the chart. We therefore do not trade in line with these minor counter trend lines, as they are against the major trend of the chart. They only become useful once they have been broken, as this is an indication that the major trend is taking over again and we can be on the lookout for entries that are in line with this major trend. Notice the strong downward moves that occur once these minor counter trend lines are broken.

Let's walk through another example. First we will establish the major trend line and then we will locate any minor trend lines going along with the major trend. Finally, we will look for minor counter trend lines. Watch how the chart develops and becomes more informative as we draw each of these lines.

The following chart is the EUR/GBP 60 minute chart. Visually, we notice that the chart is pushing up.

Figure 1.12: example of an upward moving currency pair



The first trend line that is likely to stand out is a single-sided, upward trend line. Figure 1.13 shows this trend line, which has five touches with the price action.

Figure 1.13: example of a single-sided trend line



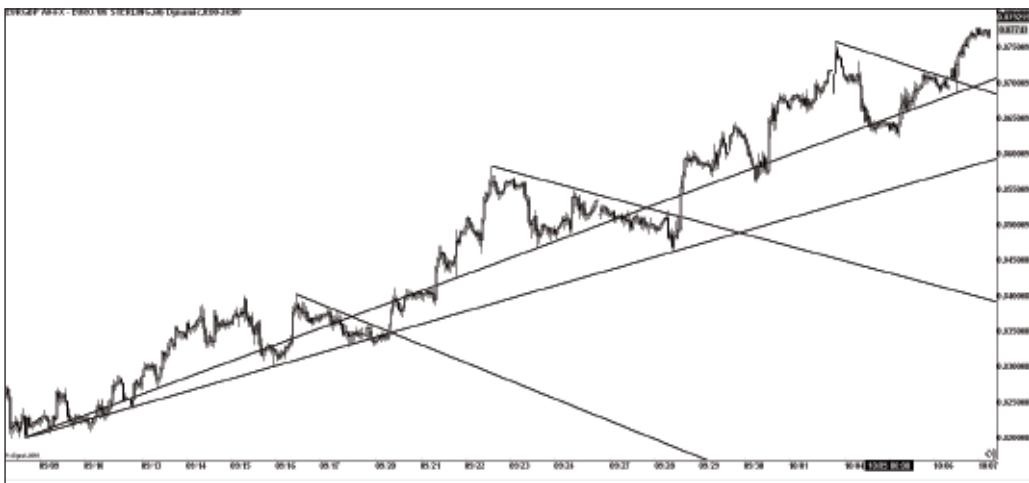
We also discover that there is a double-sided trend running through the price action. This trend line has five touches and would therefore be considered the major trend line.

Figure 1.14: example of a major, double-sided trend line



Within this upward trend, there are also a few counter minor trend lines, as seen in Figure 1.15.

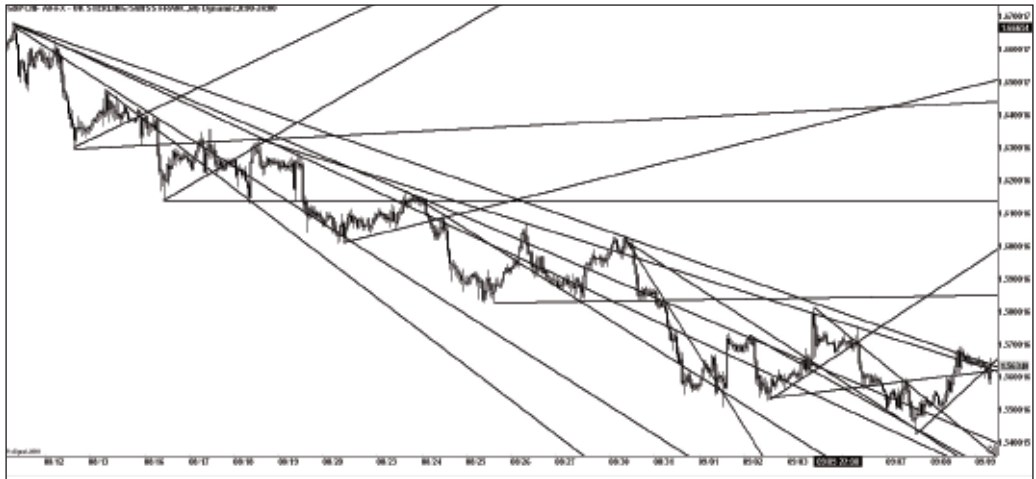
Figure 1.15: example of double and single-sided trend lines with counter minor trend lines



Once you begin plotting your major trend lines, minor trend lines and minor counter trend lines, your chart may become too busy. A busy chart is one that is so filled with trend lines that it becomes difficult to see which lines are important and which lines are not. Remember, the only reason that we are plotting these trend lines is to bring clarity and make sense of what we are looking at. A busy chart causes confusion and ultimately frustration. Frustrated traders are rarely profitable.

The following is an example of a busy chart.

Figure 1.16: example of a busy chart



Ask yourself whether your trend lines have brought clarity or confusion. If the answer is confusion, then you have too many trend lines on your chart. The best thing to do is remove all of the trend lines and start again from a clean chart.

Traders who have busy charts fear missing a trade and are desperate to exploit every single minor trend line to get an edge in the market. This type of anxiety should not be part of your trading experience. The forex market provides plenty of opportunities for the patient trader.

Summary

In summary, the major trend line is the line with the most touches to the price action which runs in the same direction as the dominant *visual flow* of the chart. The minor trend lines are lines which, run in the direction of the flow of the chart but have fewer touches than the major trend line, or lines which run counter to the major trend line. If it is difficult to discern the *visual flow* of the chart, it is likely that no trend line of any value exists. When this happens we move onto the next chart in search of a better opportunity.

Moving averages

It is worth noting here that some technical traders use the location of the current price action in relation to the 50 and 200 period exponential moving averages (EMA) to confirm

the trend. In theory any pair of moving averages may be used, for example the 10 and 20 period EMA, but in practice the most common pair used is the 50 and 200 period.

For price to be in an upward trend, for instance, the current price action has to be trading above both of these moving averages. For a downward trend, the price would need to be trading below both of these moving averages.

The following EUR/USD daily chart illustrates this point. The 50 period moving average is the dotted line while the 200 period moving average is the solid line.

Figure 1.17: example of moving average and price relationship



Notice how the current price action is trading above both significant moving averages. This indicates that, providing we have an established trend line, we would be looking for long setups. We can take this as a general rule.

In the following USD/JPY daily chart, we can see that the price action is clearly trading below both the 50 and 200 period moving averages. This is a strong confirmation of a downward trend.

Figure 1.18: example of moving average and price relationship



Moving averages are a valid tool for confirming the direction of a trend. Major and minor trend lines, however, are our main focus when determining the trend.

Trend line projection

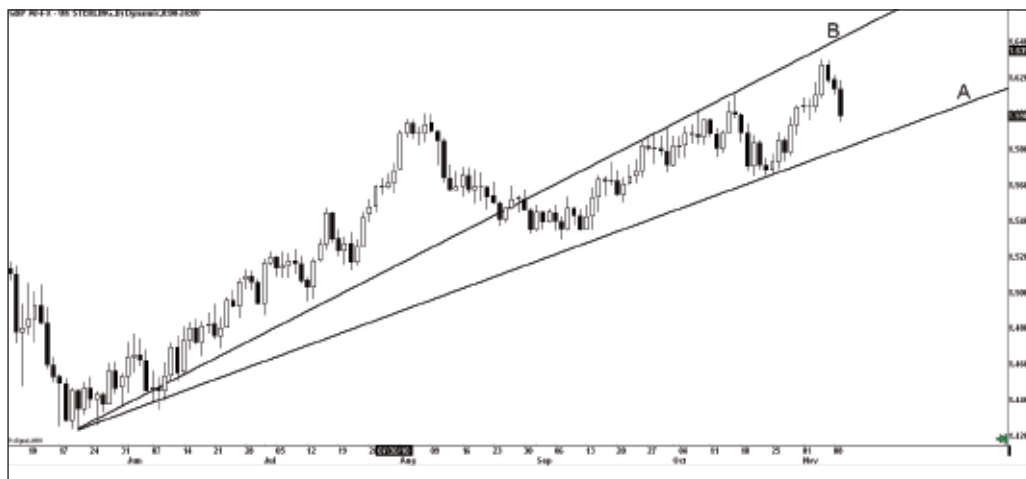
One of the main criticisms of pure technical analysis is that it is nothing more than a review of historical data, providing no insight into the future. Although I disagree with such a view, I do appreciate why it is held. It is easy to look at a chart and analyze what has happened in the past - anyone can do that.

The skill of profitable trading, however, is the ability to differentiate between relevant and irrelevant information on the chart and then to project the relevant information into the future. This is why your trend lines must be drawn with the ray tool on your charting software, instead of the segment tool. The difference is that a ray extends out indefinitely, keeping the same angle and assists in predicting significant future turning points when the price action touches it. A segment stops at the current price action and provides no indication of future price movements.

In this section, we will look at the power of projected trend lines and will learn to analyze the zones that occur as a result of multiple trend lines.

The following example uses the GBP/USD daily chart. The first thing to notice is that the trend lines are extended to the future. As mentioned, this is essential for trend line projection. We will refer to the lower, single-sided trend line as trend line A, and the double-sided trend line above it as B.

Figure 1.19: example of projected trend lines



The projected trend lines create future turning points which can be anticipated. For instance, if the price action returns to trend line A, then we can expect it to bounce and begin an upward push towards trend line B. If the price reaches up to trend line B, then we can expect a bounce back down towards trend line A.

Trend line zones

Now let's talk about the zones that have been created by these two trend lines. If I were to ask you how many zones this chart has been divided into, what would your answer be? Figure 1.20 reveals the answer.

Figure 1.20: example of projected trend lines creating zones



As you can see, the trend lines have divided the chart into three separate zones. To progress from here we need to understand not only what each zone represents, but also how to utilize each one to generate trading profits.

There are two types of zones which we will be addressing: *outer* and *inner* zones.

Let's look at the outer zones first.

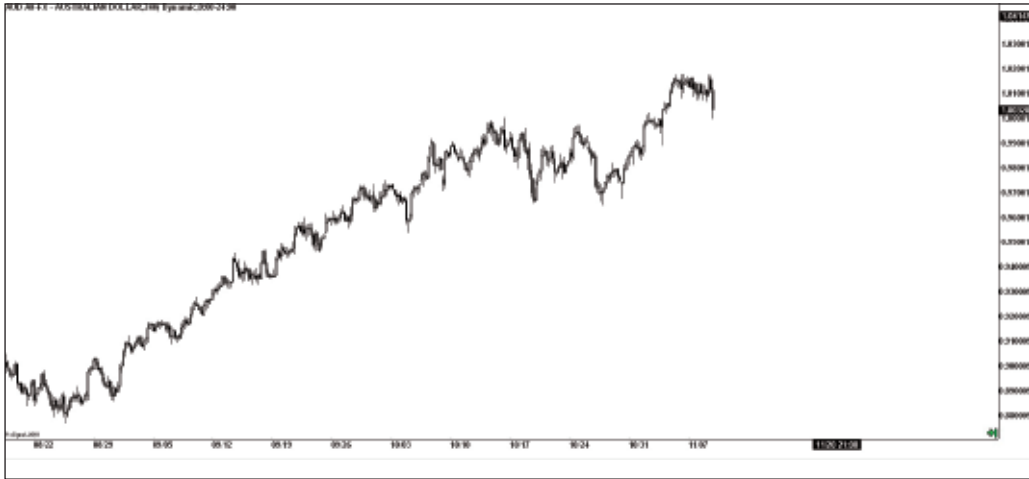
In the above example, zones 1 and 3 are the outer zones, because they are located on the outside of the current price action and are only bordered by one trend line. The outer zones represent the more extreme extensions, both in line with the trend as in zone 1, and outside of the trend as in zone 3. For instance, if the price action were to cross up into zone 1, we would consider this move to be overextended and would expect a pullback in the near future. With this in mind, we would be very wary about placing buy orders deep into zone 1. The further the price action moves into zone 1, the more likely it is that a short pullback will take place. Zone 3, on the other hand, would be an overextension of price to the short side. The deeper that the price action falls into zone 3, the more likely that there will be a strong, long pullback, in line with the dominant trend.

Zone 2 is the inner zone, as it is located in between zones 1 and 3. This zone represents the current normal trending behaviour of the currency pair. This is the zone that we can expect the price action to continue trading within. The inner zone is where we will find the highest probability setups and is therefore the ideal zone to trade in. It is in line with the overall dominant trend and does not represent an overextension of the price action on either the up or the down side.

Let's look at another example of creating zones by drawing trend lines and labelling these zones. Labelling always begins with 1 and moves in a clockwise direction. Watch how the story of the chart develops as we add trend lines and create zones.

Figure 1.21 is of the AUD/USD daily chart. There are no trend lines or zones yet, just a picture of the price action.

Figure 1.21: example of price action without trend lines



Now we'll add some trend lines.

Figure 1.22: example of projected trend lines



These are the two most obvious trend lines. The double-sided trend line is the major trend line, as it has more touches than the single-sided trend line beneath it.

Next, we'll identify and label the zones.

Figure 1.23: example of projected trend lines creating zones

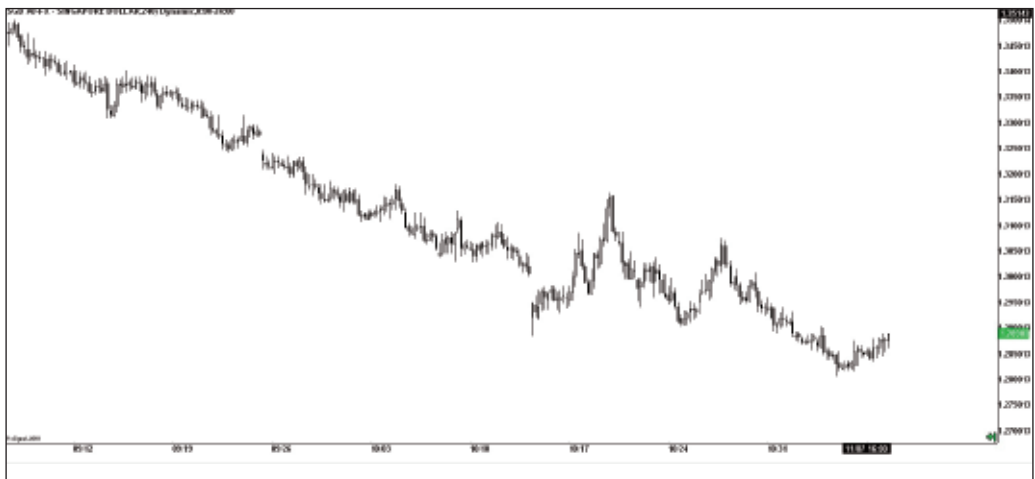


All three zones can now be seen clearly. We know that zones 1 and 3 are the outer zones, while zone 2 is the inner zone and the zone where will look for the majority of our setups.

Let's look at another example; this time the trend is moving down.

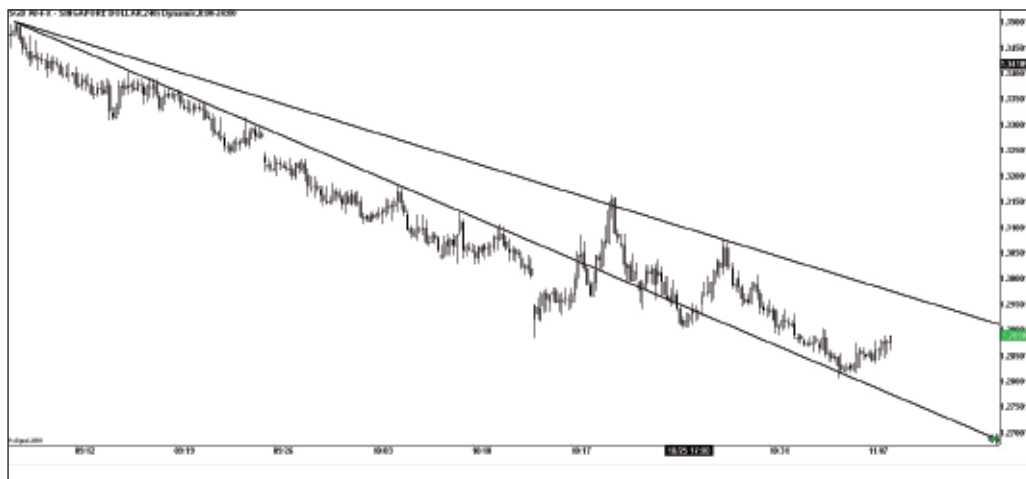
Figure 1.24 is the USD/SGD 4 hour chart. Again, watch how drawing trend lines and creating zones brings clarity.

Figure 1.24: example of price action without trend lines



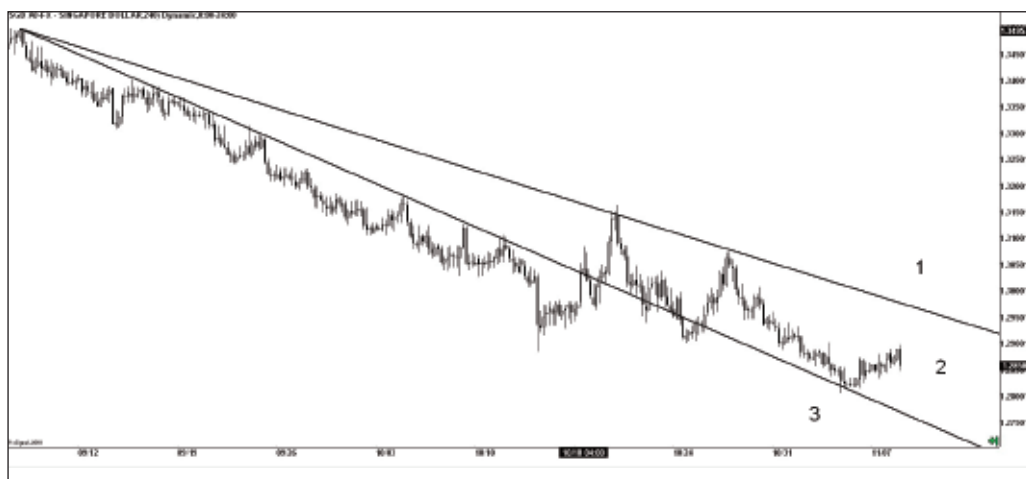
Let's add the trend lines.

Figure 1.25: example of projected trend lines



The addition of the major and a minor trend lines have created three zones again. Let's label them.

Figure 1.26: example of projected trend lines creating zones



Zone 2 is the inner zone and the zone where we expect to trade within. Zones 1 and 3 are the outer zones, representing the overextensions of the price action.

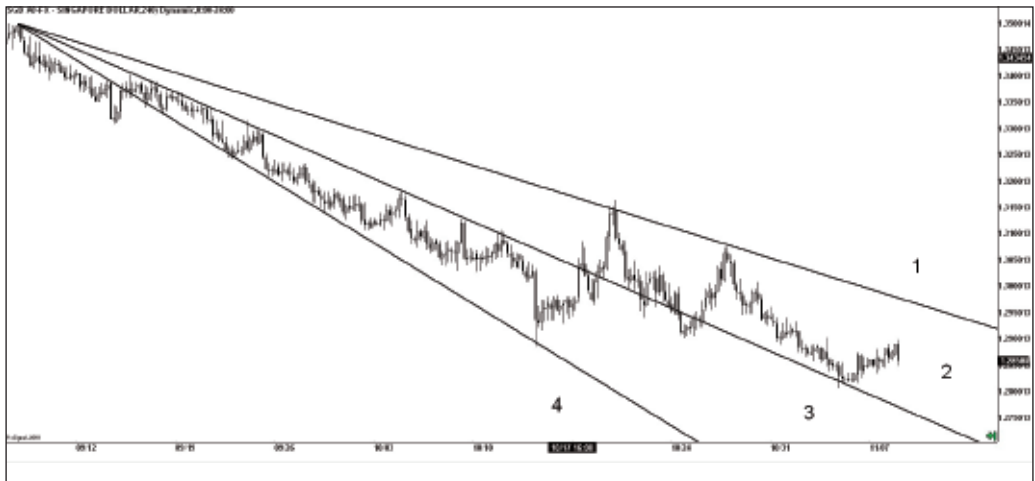
A question now arises as to how many zones should be created.

To answer this, you must first remember that a busy chart causes confusion, frustration and poor trading results. To avoid busy charts, we will set the maximum number of zones at four; meaning not more than three trend lines should be drawn.

Remember that we are now talking about zone creation trend lines, which will be a combination of the major trend line and the minor trend lines but will not include the minor counter trend lines, as they run counter to the *visual flow* of the chart. Later on, we will explore the benefits of counter minor trend lines and the various patterns which they create on our charts.

Looking at Figure 1.26 again, you should be able to spot another trend line. Figure 1.27 reveals this third trend line.

Figure 1.27: example of an additional zone created by a further trend line



The addition of another trend line has created a fourth zone, meaning there are now two inner zones. We've already established that the inner zone is the place to expect most trading to be done, but now that we have two inner zones, we need to know whether one has greater value than the other.

To find out, we identify which inner zone the price action is currently trading in. In the example above, we can see that the price action is currently in zone 2. We can therefore consider zone 2 to have more value than zone 3 – even though both are inner zones. Before zone 4 was created, we considered zone 3 to represent an overextension of price, meaning we would expect potential sharp pullbacks and would be cautious about going short too deep into this zone. Zone 3, however, is now an inner zone, so trading within it becomes more appropriate.

It is worth noting that when we draw trend lines for the purpose of zone creation, they all start from the same peak if the general trend is down or from the same trough if the general trend is up. This is another reason why the minor counter trend lines are not used to determine trending trading zones – they cannot be drawn from the same peak or trough as the other trend lines.

Summary

In summary, drawing trend lines creates zones. It is best to keep the maximum number of zones at four, to guard against a busy chart. The outer zones represent the overextended areas of the chart and are therefore not ideal for trading. This is because when price gets too extended it becomes more difficult to predict turning points, which can be fast and furious. In the inner zones, safer, more stable price action is found. This is where we look for the majority of our setups. If there is more than one inner zone, greater value is placed on the zone where current price action is happening.

ENTRY AND EXIT STRATEGIES

As we have seen, trend lines provide us with the information required to determine whether to look for long or short trades and create projected trading zones which help us to know if the price action is trading within its normal trend, overextending too quickly or breaking out of the current trend. It is now time to look at two trend line trading strategies, both of which clearly define the entry, risk exit (stop loss) and target exit (take profit) of the trade.

Successful trading strategies always define the entry point of a position relatively precisely. All entries can be classed as either a bounce-off or a break-through a certain level. There is no other form of entry in technical trading. The two strategies we will be looking at are:

1. Trend line bounce strategy
2. Trend line break strategy

1. Trend line bounce strategy

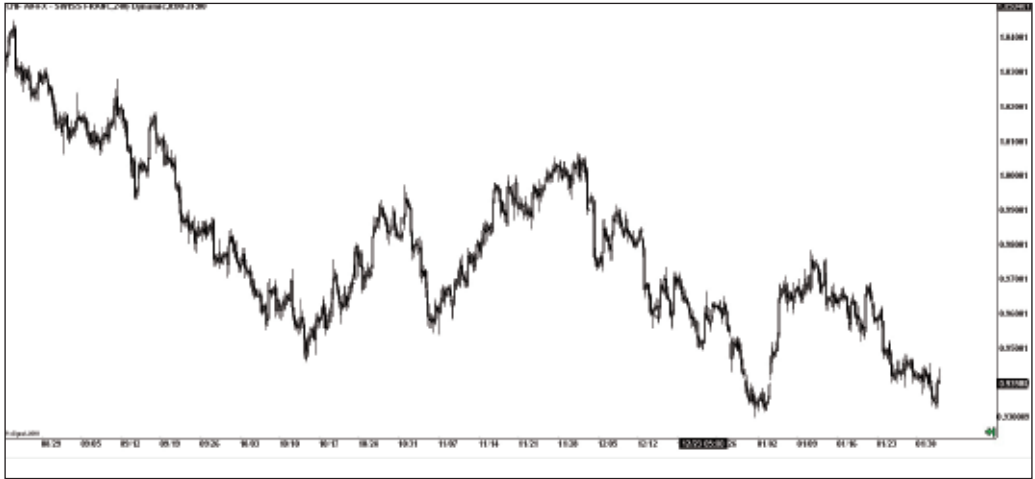
The aim of the trend line bounce strategy is to catch the move of the price just as it bounces off the trend line and rejoins the flow of the trend.

This approach is relatively aggressive compared to more traditional styles of trading. By aggressive, I mean that we will be looking for buying opportunities while the price action is falling into an upward trend line and looking for selling opportunities while the price action is rising into a downward trend line.

More conservative traders wait for the price to action begin to change direction before entering a trade. But while this approach stops us from entering the occasional bad trade, it also reduces the amount of profit taken from winning trades. Over time, this will have a dramatic effect on the overall return.

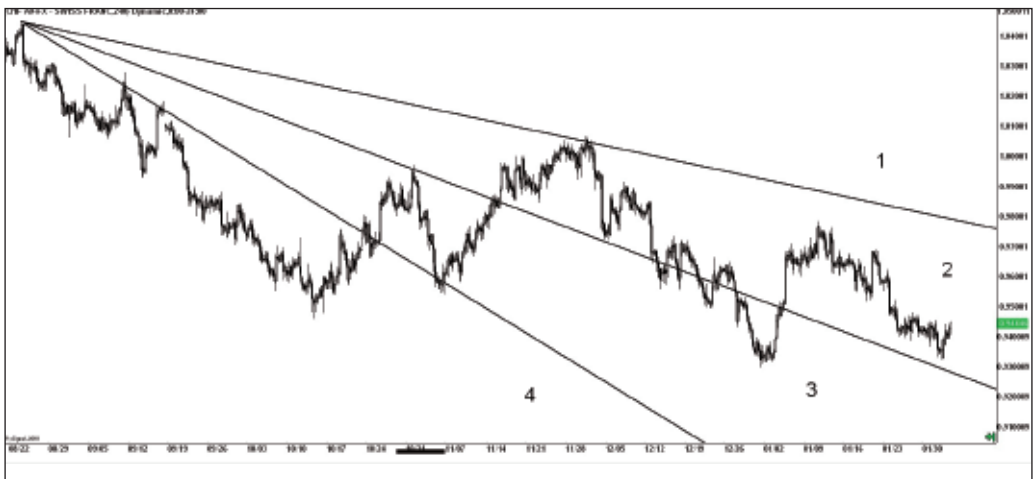
Let's begin going through the trend line bounce strategy by clearly defining its entry. We will use the USD/CHF four hour chart in Figure 1.28 as our example chart.

Figure 1.28: price action without trend lines



This image makes it clear that the price action is trending down, so we know that we only need to look for short positions. Let's draw some trend lines and see if we have any projected zones to work with.

Figure 1.29: projected trend lines creating zones



The addition of the three trends lines, as drawn in Figure 1.29, reveal four projected trading zones. Zone 2 is the primary trading zone because that is where the price action is currently located.

Entry

The entry for this trade should take place when the price action retraces back up to the trend line that divides zones 1 and 2 and touches it. While we can look at the chart to estimate when this touch is likely to occur, we can't define the exact entry price until the price action makes this touch.

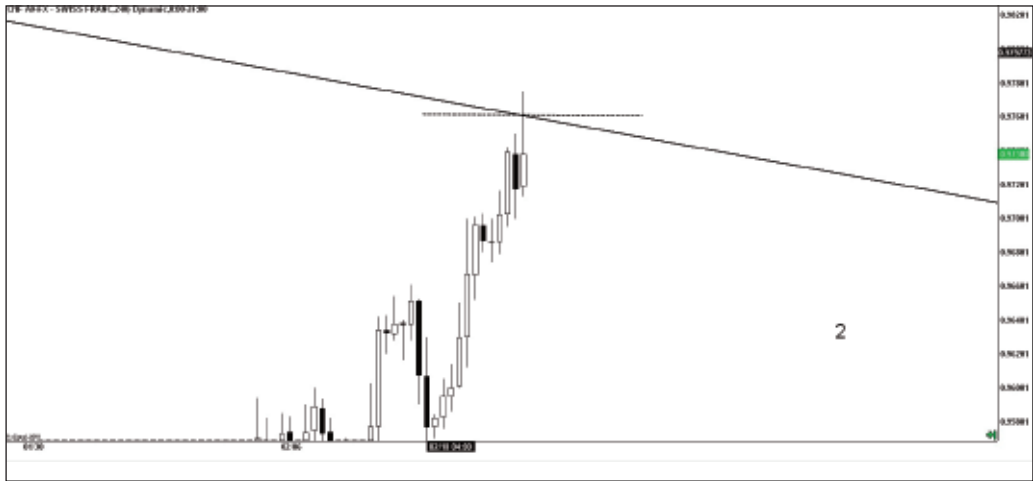
The longer it takes to get to the trend line, the worse the entry price will be. This is because the trend line is pointing down. As time goes on, the trend line, and therefore the potential entry price moves down. The lower the selling price the less efficient the entry. If we sell at a higher price, the price action has more room to fall making our potential profit much greater. The opposite is true for a long position. The lower the price of our entry, the more room the price action has to rise. In this example, the faster the price action retraces back to the trend line, the better the entry point is. Psychologically, it can be very difficult to press the sell button when the price is racing up, but the ability to do this is an important characteristic of a successful trader.

Figure 1.30 is zoomed in for a closer look at the anticipated entry for this short trend line bounce trade. The circle indicates the area where we expect the bounce to occur. We can never know for sure where, or even if, the price action will hit the trend line, but making an estimate helps to build our intuition and confidence.

Figure 1.30: anticipated entry



Figure 1.31 shows the continuation of the price action and the moment that our short entry should occur. The exact point of entry is indicated by the dotted line.

Figure 1.31: actual entry

We enter at the exact moment that the price action touches the trend line.

Entry summary

The five steps of entering the trend line bounce trade are:

1. Determine the direction of the price action – up or down.
2. Identify and draw any trend lines.
3. Label the projected zones created by the trend lines.
4. Estimate a general area for the potential bounce to occur.
5. Wait for the price action to retrace (come back to) the trend line. Enter at the moment that the price action makes contact with the trend line.

Exit – Risk

Now that we know our entry we need to identify where our stop loss must be placed. Here you have two options:

1. Place the stop loss 5 pips above the previous swing high (if going long it would be 5 pips below the previous swing low). 5 pips allows for the broker's spread as well as a small amount of volatility.
2. Place the stop loss 5 pips above the previous touch of the trend line which was used to define the entry (if going long it would be 5 pips below the previous touch of this trend line).

The appropriate option to use is normally determined by the setup itself. For instance, in this example the previous touch of the trend line is a considerable distance away from the entry point and is, therefore, not a good guide to use for the stop loss placement. The previous swing high gives us a nice tight stop loss for our short position. In Figure 1.32 both options are circled. The dotted line represents the stop loss placed next to the previous swing high as opposed to the previous touch on the trend line.

Figure 1.32: options for the placement of the stop loss



When seen on the chart, it is clear that the previous swing high is a better indicator for our stop loss placement in this specific trade.

Exit – Target

The target for this trade is determined by the previous dominant swing low of the price action. The exact target price is the price of the lowest point of that swing. The circle in Figure 1.33 highlights the dominant swing low and the dotted line represents the price level of the target.

Figure 1.33: target



The chart also reveals that the target price is actually a support level which the price action has bounced off in the past. In Figure 1.34 shows this more clearly.

Figure 1.34: a support level that is consistent with the target



We have now defined our entry, stop loss and target price for this trend line bounce trade. Figure 1.35 shows the continuation of the price action as it reaches our target. Notice that the entry and both exit levels are all marked with dotted lines. From top to bottom these lines represent the stop loss, the entry, and the target.

Figure 1.35: entry, stop loss and target of the trade as well as the outcome



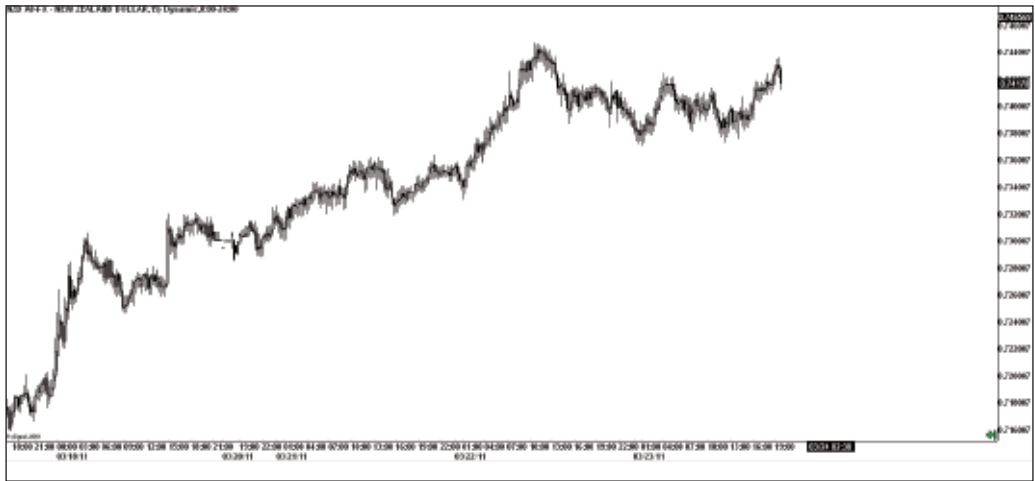
Summary

We see here that the trade runs smoothly down and hits its target. This type of trade requires a certain amount of confidence. Look at the upward move that led into the bounce entry. It may not feel natural to sell while the price action is pushing up so fast. Remember, however, that the overall trend was going down and we had three very strong trend lines confirming that. We are counting on the strength of the downward trend to outweigh the strength of the momentary upward move.

Another example

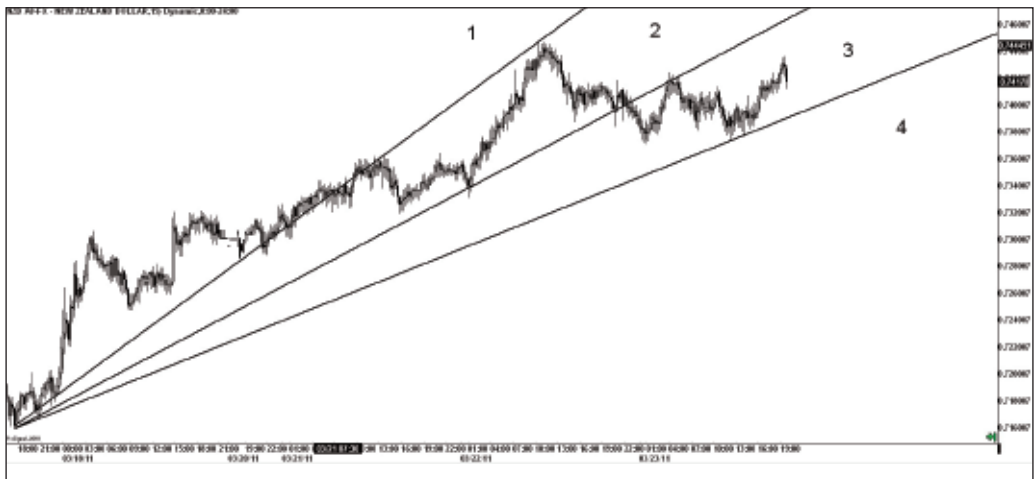
Let's look at another example of the trend line bounce. This time the price action is moving up on the NZD/USD 15 minute chart shown in Figure 1.36.

Figure 1.36: price action without trend lines



We know from this chart that we are only looking for long trades. Now we need to draw our trend lines and create our zones.

Figure 1.37: projected trend lines creating zones



Having added our trend lines and zones as shown in Figure 1.37, we can see that the primary zone is zone 3 as this is where the price action is currently trading. We also know that we are looking for a bounce to occur on the trend line between zones 3 and 4. Figure 1.38 zooms in and highlights, with a circle, the area where we anticipate the bounce may take place.

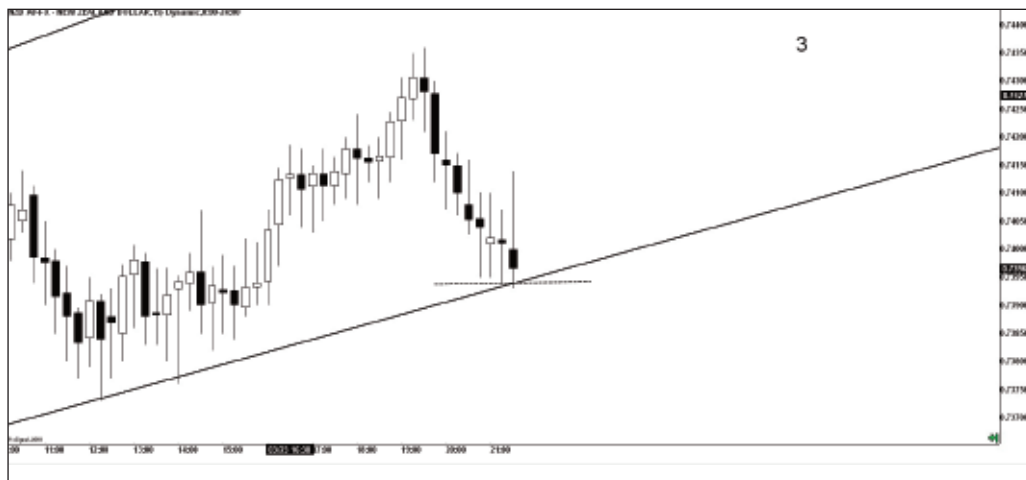
Figure 1.38: anticipated entry



Remember, although it is impossible to predict the exact entry point, estimating the location of a potential bounce helps build a feel for trend trading and develops intuition.

Figure 1.39 zooms in even further to reveal the exact point of entry as the price action falls and touches the trend line. The dotted line marks this entry.

Figure 1.39: actual entry



Once our entry has been determined, we can put our stop loss and targets in place for the long position. Again, we have two options for placing the stop loss. We could either use the previous swing low or the most recent touch on the same trend line which is being used to determine our entry. To do this, we would place the stop loss 5 pips below this last touch.

The target is decided by the previous dominant swing high. Figure 1.40 zooms back out to expose these two price levels with dotted lines. As we are going long, the stop loss is the lowest dotted line while the target is the highest dotted line. The entry is the dotted line in between the two.

Figure 1.40: entry, stop loss and target of the trade

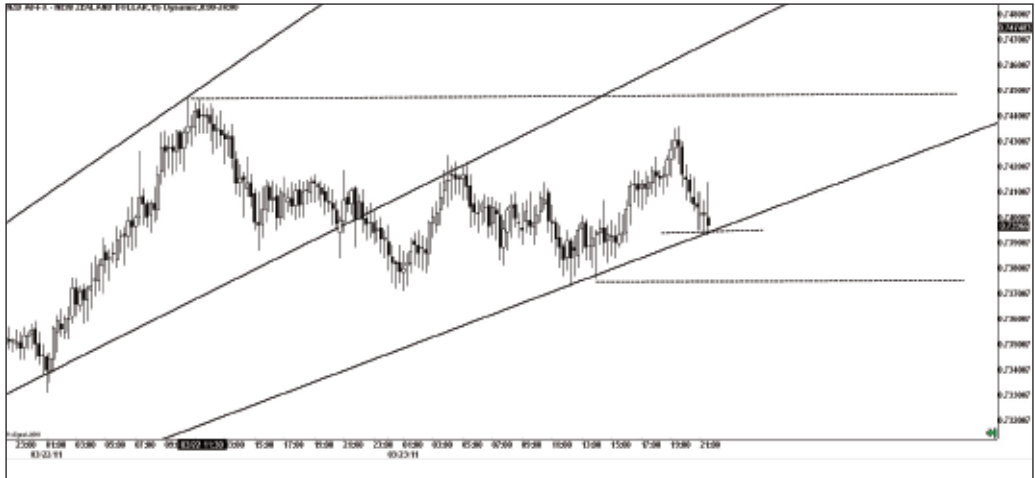
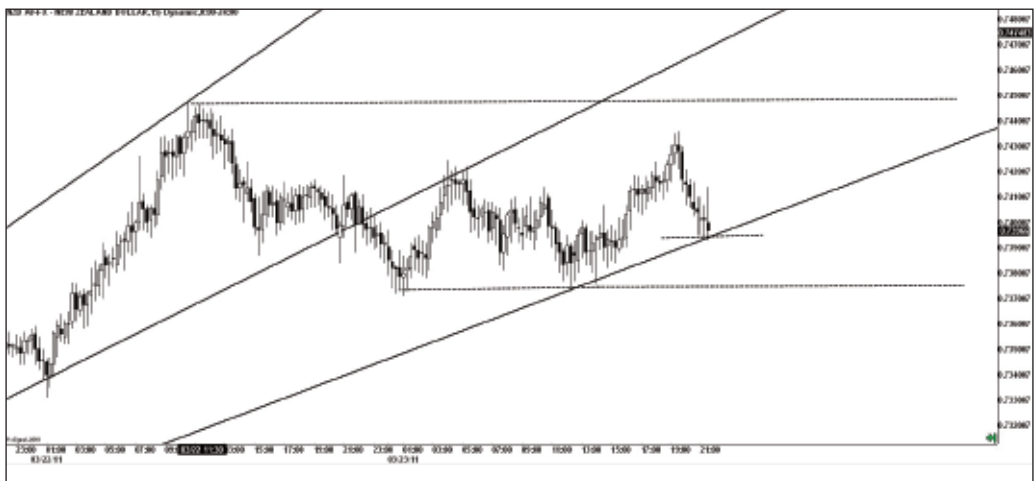


Figure 1.40 also reveals another interesting point. Notice how the stop loss level also happens to be a level of support. Figure 1.41 extends the dotted line further to the left to demonstrate this point.

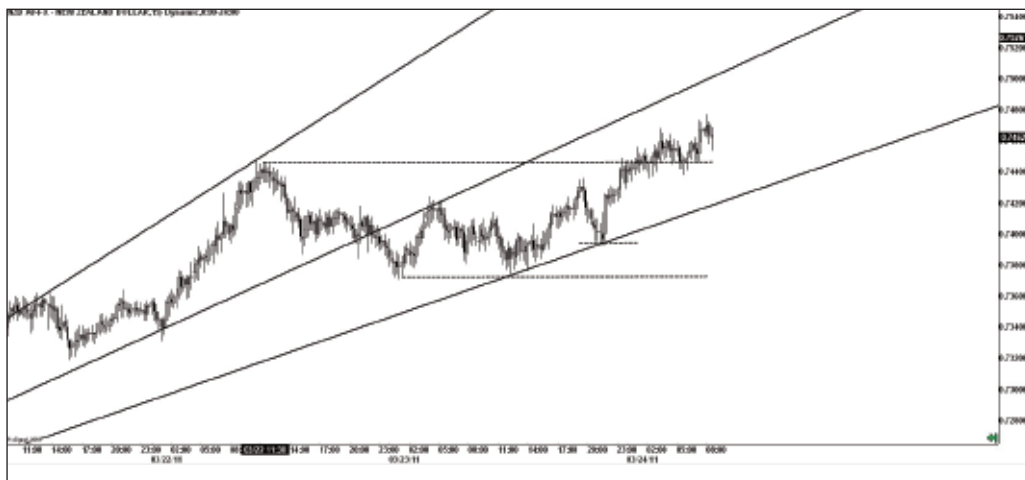
Figure 1.41: support level that is consistent with the stop loss



The fact that we have had support at our stop loss level in the past is a good sign. From this, we know that to be stopped out of our position, the price action not only has to break down through its trend line, but also break a previous level of support.

Figure 1.42 zooms back out and shows the continuation of the price action as it reaches our target.

Figure 1.42: outcome of the trade



The NZD/USD 15 minute chart shows us a typical example of the trend line bounce strategy working effectively on a long trade.

Summary

Trading the trend line bounce strategy consistently on currency pairs that we are familiar with is a great way to generate considerable and sustainable trading profits.

2. Trend line break strategy

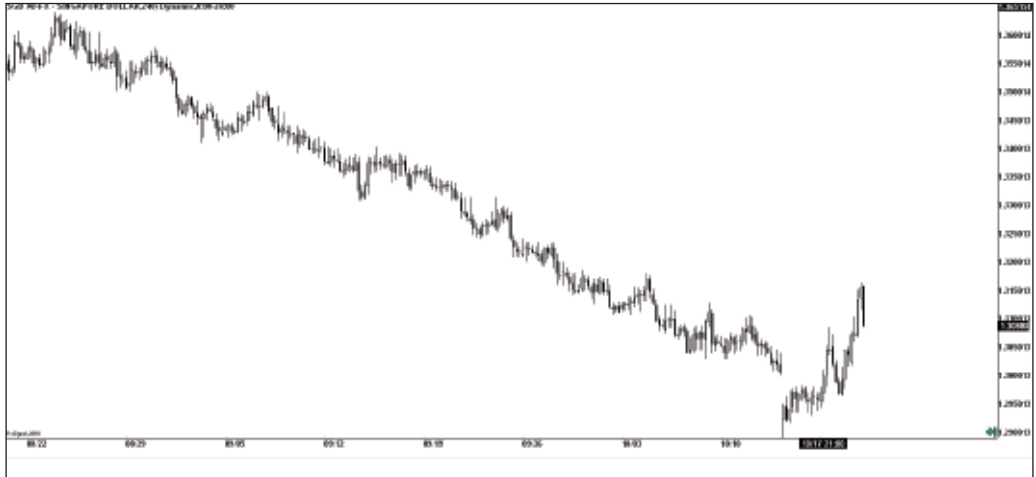
The purpose of the trend line break strategy is to profit from a move of the price as it travels from an outer zone back into an inner zone, rejoining the flow of the trend. On a four-zoned chart with three trend lines, this will mean that the price action breaks back into zone 2 from zone 1 when going short, or into zone 3 from zone 4 when going long. On a three-zoned chart with two trend lines, this will mean that the price action breaks back into zone 2 from zone 1 when going short, or into zone 2 from zone 3 when going long.

Let's begin exploring this strategy by looking at the entry.

Entry

Figure 1.43 is a USD/SGD four hour chart.

Figure 1.43: price action without trend lines



Clearly, the price action on this chart is trending down. This means we only need to look for short positions. Let's draw our trend lines.

Figure 1.44: projected trend lines creating zones

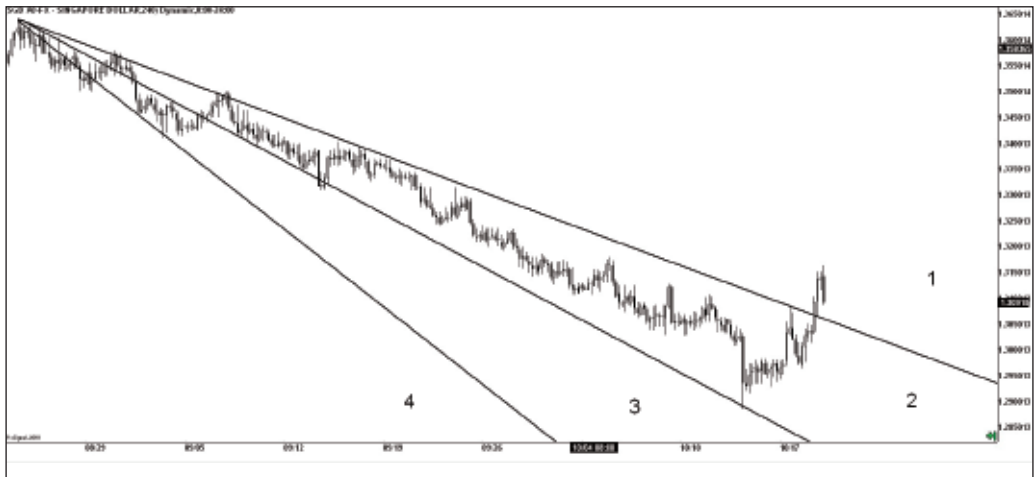


Figure 1.44 shows the trend lines and reveals four projected zones. We can see that the price action is currently trading in zone 1, which is an outer zone in a strong downward trend. At this point we wait patiently for the price action to enter back into zone 2. The quicker it drops, the better our entry will be.

Although we are expecting the price to drop back into zone 2, that in itself is not enough to warrant entering a trade. We first need to see the price come back into zone 2 and a candlestick to close in this zone. Figure 1.45 zooms in to show the moment this happened, highlighting the exact entry level with a dotted line.

Figure 1.45: entry



As you can see the short entry occurred as soon as the candlestick closed in zone 2.

Summary

The 5 steps to entering the trend line break trade are:

1. Determine the direction of the price action – up or down.
2. Draw any trend lines.
3. Label the projected zones created by the trend lines and understand which zone is the primary zone.
4. Check that the price action is in the relevant outer zone.
5. Wait for the price action to move back into the relevant inner zone. Enter as soon as the candlestick closes in this inner zone.

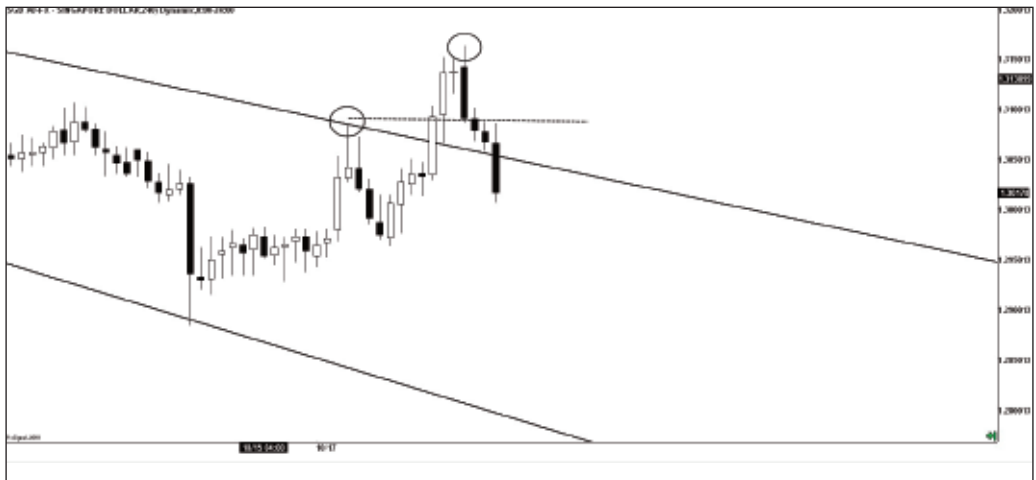
Exit – Risk

There are two options for the location of the stop loss in the trend line break strategy:

1. Place the stop loss 5 pips above the previous swing high when going short or 5 pips below the previous swing low when going long. Either of these swings will be located in the outer zone.
2. Place the stop loss at the level of the previous touch on the trend line which the price action is coming back to.

As with the trend line bounce strategy, the setup itself will be a strong indicator as to which option to use. For this example, we will place our stop loss 5 pips behind the previous touch of the trend line, a reasonably safe distance from our entry. Figure 1.46 zooms out to show each stop loss option which has been circled. The dotted line identifies the chosen option.

Figure 1.46: options for the placement of the stop loss



Exit – Target

The target for this trade is the previous dominant swing low, shown with a dotted line in Figure 1.47.

Figure 1.47: target



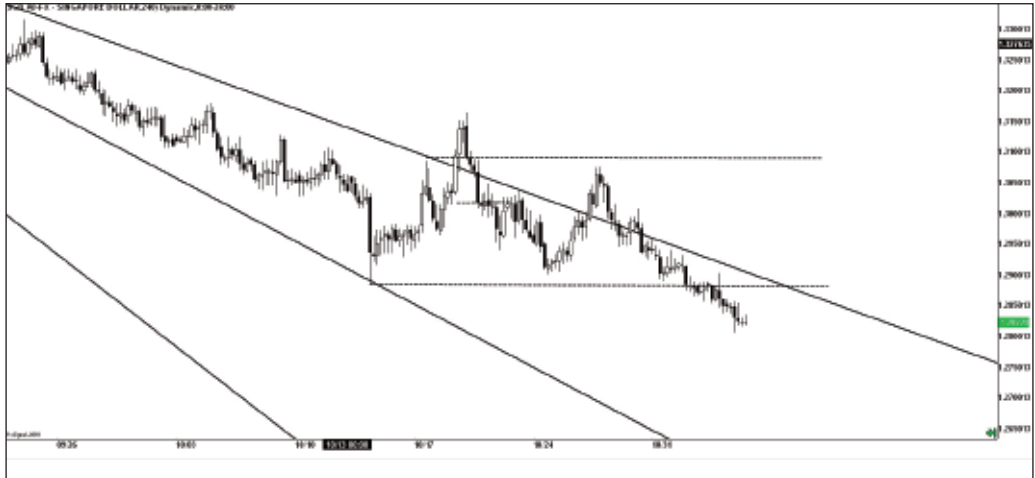
We have now defined our entry, stop loss and target prices. All three are shown in Figure 1.48. As we are going short, the top dotted line is the stop loss, the middle dotted line is the entry and the bottom dotted line is the target.

Figure 1.48: entry, stop loss and target of the trade



Figure 1.49 shows the continuation of the price action as the trade eventually reaches its target (which was just below 1.29003) – a successful execution of the trend line break strategy on a short trade.

Figure 1.49: outcome of the trade



Summary

We see here that the trade runs smoothly down and hits its target. This type of trade demonstrates the power of the trend. For a relatively short period of time, the price moves upward against the trend. Once the pressure of the trend takes over, however, the price is pushed back underneath the trend line providing us with our opportunity to enter. In this setup, we are counting on the strength of the downward trend to outweigh the strength of the short-term upward move.

Key 1 Summary

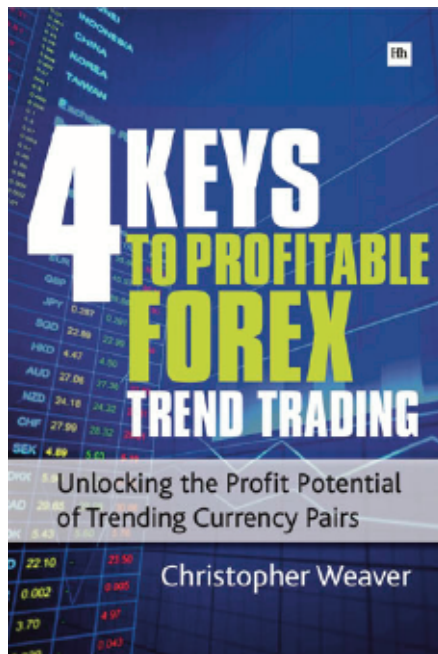
Trend lines are one of the most powerful keys in forex trading. They add clarity to the charts and unlock the profit potential of trending currency pairs.

You should now be able to differentiate between major and minor trend lines and understand what makes them single or double-sided. You should also be able to break your chart into separate zones without allowing it to become too busy. Most importantly, you should be able to spot profitable trades using nothing more than the price action and a few, simple trend lines.

4 Keys to Profitable Forex Trend Trading

Unlocking the Profit Potential of
Trending Currency Pairs

Christopher Weaver



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