BASICS OF FOREX TRADING

EXCLUSIVE EDITION

FINANCIAL HUB

Welcome To The

Financial Hub

E-BOOK

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It is extremely difficult for the retail trader to solely rely on this method for generation of high probability trades. This because at the retail level most traders are swing and day traders, this means they will not hold positions in the markets for long, also it is extremely hard to get data fast at the retail level. Institutions are highly favored when it comes to data release. We have therefore not gone through many concepts under this topic; it is the job of the trader to dig deeper into this topic so as to understand data releases and geo-politics which are the main drivers of fundamentals.

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Journaling has been named as one of the six habits that have led to success among many successful individuals and organizations. The act of Journaling is highly recommended in trading financial markets, this enables the trader to learn his mistakes upon doing a journal review. The trader is also able to keep tabs on how his performance is progressing. Ignoring this act and going the other route is something that you will deeply regret after staying in the markets for long. Learning how to trade is an exercise that will require use of the feedback loop which will be facilitated by use of the journal. We have however not shared how we journal our work, this is because we think this is an act that should be done personally. Traders are therefore expected to be creative and come up with innovative and creative ideas of journaling.

INTRODUCTION

HAVE YOU HEARD OF FOREX TRADING? I bet yes, the fact that you have come across this book means you have an interest in learning and understanding how one can make a living trading the forex market. Over the last 3 years we **(Financial Hub Team)** have been engaged in trading the forex market, during this time we have been able to learn a lot; both what works and also what doesn't work in the markets.

We have studied **history of markets, strategies, indicators, technical analysis, fundamental analysis, mental analysis, technology and even robots.** We have tested **indicators, strategies, trading signals and even tried trading news but none of this worked all the time.** We kept on hitting the wall, not getting to profitability. It was not until we understood how the markets work that we were able to combine everything we had learnt into something concrete that can be used to trade the markets.

WHY WRITE THIS BOOK? We had no intention of writing a book. In fact we never intended to teach forex trading. It was only after friends requested that we should share what we were learning that we thought of designing a course. In the process of designing we had one package that was to be given out for free.

Why free you may wonder? In our journey of trading we came upon many resources which were very useful for us in learning how to trade the markets. We also came across scammers, I remember at one time paying up front $50 for us to get signals which we never got. These two scenarios inspired us to share valuable content and information that could help the newbie in his/her journey of trading. This is also a plot to shame and shun the scammers, those who sell basic information promising quick results in the markets.

Consider this a blue print on how to go about your journey of forex trading. This is more like a basic introduction to the forex market offering you with what is important for you to succeed in the markets.

This book is therefore designed to guide in the following way in your journey of trading.

First we will **introduce you to the financial markets**, mentioning the several assets that can be traded in this space. We will then **focus on foreign exchange** showing you how it began and how the markets have evolved into a six trillion dollar market a day. The next section will cover how the markets work, the players, terminologies to be used in this industry and finally guide you into how one can open a demo (virtual account) which can be used for practice.

Second, we will guide you into several technical tools that can be used to form a trading strategy and generate high probability trade setups. We will cover each tool individually, sharing how the tools can be used. The trader should therefore practice using these tools since our brains only learn based on repetition.

We will also introduce you to technical indicators and show you why we think they are not good to be used in forex trading, the trader can however go forward to examine and test these indicators on a demo account. We still believe that testing your hypotheses and beliefs is the only way to confirm your suspicions.

Third we will take you through some simple concepts on fundamentals, we have consciously chosen not to go deep into this topic because we believe that one can solely rely on technical analysis and succeed in the markets. We also do believe that it is extremely hard for the newbie to understand and grasp this concept upfront without a background in finance or the markets.

Fourth, we will tackle one of the most topics to understand so as to succeed in the markets. The psychology of trading is tailored to make the trader understand the nature of markets and most important of all to understand himself. Knowing thyself is paramount in the markets; we do believe that we don't trade markets but our beliefs, hopes and biases. Learning mind techniques and ways of thinking is essential to succeed in the forex markets.

Fifth, we will dive into the topic of risk and money management. **It is said that "it's only when the tide goes out that we knows who's been swimming naked".** The essence of understanding this topic is to make sure that traders protect the downside. **Eliminating risk is impossible, without risk basically there is no return.** Learning how to manage risk is what will make you a fortune, risk management is subjective. We all have different risk tolerance levels, risk appetites and confidence levels. We have therefore decided to share the different strategies we use to come up with tactics in managing risk and money, leaving you with the task of designing your own tactics.

Finally, we will dive into the topic of a trading plan and a trading journal. We will show you the different elements that are important in designing your trading plan. This will be crucial as this will serve the purpose of guiding you in your journey of trading.

In addition to this, we have filmed videos which will be released every Week on our YouTube channel. Some of the links have been shared on the text below but one can also access and view the channel using the links below:

https://www.youtube.com/channel/UCGZ595tFkjl4UOH3S9_GQ7Q/videos

Readers can therefore go through this book concurrently watching the videos; this will serve the purpose of helping the trader understand the topic and concepts deeply.

We hope that this book will reach as many newbies and forex traders as possible, if you find some of the information in here valuable please share with your fellow traders. We would also warn you upfront that we don't expect you to pick everything in the book, learning a concept or two about the markets will prove to be valuable both to us and to you the reader.

In conclusion, if you are able to spot anything valuable from this book, you can then consider purchasing our course or joining our community of traders on the site for updates on the forex and commodities.

The following links will serve the purpose of helping you join our different platforms for updates:

TELEGRAM - https://t.me/FinancialHub

WHATSAPP - https://chat.whatsapp.com/B5oCDvf8Pd00UvR9wMpXDt

WEBSITE - http://financialhub.co.ke/

<u>INTRODUCTION TO FINANCIAL MARKETS</u>:

The Financial markets are made up of buyers and sellers who participate in the exchange of many **assets** traded at a price determined by the forces of supply and demand.

Some of the Asset Classes include;

- **Commodities and Precious Metals** such as: gold and silver, Energy (crude oil, gasoline), Agriculture (cotton, soy beans), among others.
- **Equities** – this is simply the stock/shares market
- **Treasury Bonds and treasury bills**
- **Corporate bonds**
- **Derivatives**
- **Crypto currencies**
- **Currencies (foreign exchange)**

At Financial Hub, we mainly focus on trading **Currencies and Commodities** with a special focus on **Oil and Gold.**

<u>WHAT IS THE FOREX MARKET?</u>

The Foreign Exchange market is where large investors, banks, businesses, government and individuals buy and sell world currencies. It is by far the largest, most liquid market in the world with roughly 6 trillion dollars being traded every day. Its Open 24 hours a day, five days a week, hence offering Liquidity due to much trading volume .

Liquidity is important in this case because it enables participants to get in and out of the market quickly.

Unlike the Stock market, Forex trading is an over-the-counter (OTC) market meaning it is not conducted in a physical location, but this was not the case in the beginning. We will therefore go through a brief history of the forex market.

HISTORY OF FOREX TRADING

Between 1944 and 1971, the value of all world's currencies was all pegged to the United States Dollar (USD$), which was pegged to Gold. It was a way of stabilizing the economy which was highly volatile after World War II but as the years went on, countries grew tired of this system. This went on until 1971 when the US president at that time, President Richard Nixon eliminated the gold standard for the U.S., effectively cutting the connection between the US dollar and gold.

This new free floating environment in which value of currencies appreciates or depreciates based on factors of supply and demand soon gave rise to the modern forex market.

Examples of most traded currencies are the **United States Dollar, the Euro, the Japanese Yen, The British Pound Sterling, the Swiss Franc, the Australian Dollar, the New Zealand Dollar, the Swedish Krona, the Canadian Dollar and the Norwegian Krone.**

They are commonly referred to as the **G10 currencies.**

HOW THE FOREX MARKET WORKS?

Currencies are traded in pairs in the forex market, there are always two instruments (currencies) traded against the other. For example, when a person from Europe travels to America, on arrival he or she has to convert their native currency, which is in Euros to U.S Dollars. And for every 1 Euro you give, you receive 1.5 U.S Dollars (1 Euro = 1.5 U.S Dollars). In such a scenario, it is always written down as an exchangeable pair e.g. EUR/USD = 1/1.5. The first currency on the left, in this case the Euro, is referred to as the **Base,** and the latter is known as **Quote,** in this case the U.S Dollar.

The most popular traded pairs, also known as the Majors, are the currencies that are traded against the **U.S Dollar.** For example, **Euro against the U.S Dollar (EUR/USD), Great British Pound against the U.S Dollar (GBP/USD) or the U.S Dollar against Japanese Yen (USD/JPY).** These pairs are widely traded by traders and have very high volatility.

The other pairs which are not quoted against the **U.S Dollar are** known as **Cross Currencies.** They include **Euro against Japanese Yen (EUR/JPY), Great British Pound against Japanese Yen (GBP/JPY)** among others. Cross currencies are advantageous as they allow traders to trade currencies that are not co-related to the U.S Dollar, especially when the U.S. Dollar is unstable.

It is therefore very important for you to understand how these pairs move. At any one moment**, when one of the pairs is appreciating in price and value the other is depreciating.**

In this case, **when the Euro is getting stronger, it means the U.S Dollar is getting weaker, and when the U.S Dollar is getting stronger, the Euro is getting weaker.** They are **simply inversely proportional** when quoted one against the other. There is no one time that you will get the two pairs quoted against one another **both appreciating and depreciating in price and value** at the same time.

You can watch the following video for further clarification: (https://www.youtube.com/watch?v=ZBlavOewhic&t=11s)

MAIN PLAYERS OF THE FOREX MARKET

We will begin by highlighting that the Forex market is an international over-the-counter market (OTC). It means that it is a decentralized, self-regulated market with no central exchange or clearing house, unlike stocks and futures markets.

This structure eliminates fees for exchange and clearing, thereby reducing transaction costs.

The Forex OTC market is formed by different participants – with varying needs and interests – that trade directly with each other. These participants can be divided into various groups.

Interbank - These large banks that collectively control the largest volumes of forex transactions each day for both their customers and themselves. Examples include **Citi, JPMorgan, UBS, Barclays, Deutsche Bank and HSBC.** They control over 50% of the money in this sector.

Commercial Banks/Large Corporations -This are huge companies that transact big money in dollars. For example; Mergers and acquisitions (M&A) between large companies can create currency exchange rate fluctuations (EUR/USD). If company **X** in Europe was acquiring company **Z** in USA they would have to transact in either native currency.

Since the volume they trade is much smaller than those in the interbank market, this type of market player typically deals with commercial banks for their transactions.

Corporations represent companies that are engaged in import/export activities with foreign counterparts. Their primary business requires them to purchase and sell foreign currencies in exchange for goods, exposing them to currency risks.

Hedge Funds- This are private investment funds that speculate in various assets classes. Macro Hedge Funds pursue trading opportunities in the Forex Market. They design and execute trades after conducting a macroeconomic analysis.

Due to their large amounts of liquidity and their aggressive strategies, they are a major contributor to the dynamic of Forex Market.

They pool money from wealthy people and institutions such as pension funds, retirement funds, Insurance Companies etc.

Retail Traders - These Are Individual traders who trade the Forex Market using their own capital in order to profit from speculation on future currency exchange rates.

They mainly operate through Forex platforms that offer tight spreads, immediate execution and leveraged margin accounts. Retail traders control the least money in the forex market.

We also did a video illustrating the hierarchy of the players in the forex market. Links below (https://www.youtube.com/watch?v=T5dFVjhxKg4&t=4s)

FOREX TERMINOLOGIES

Price Action- It is the overall analysis of price movement of a given market for a period of time displayed in overall patterns.

Chart - It showcases price action and trading opportunities in the market. The vertical axis shows price movement and horizontal shows the time period.

Quote - Exchange rate between two currencies (EUR/USD)

Ask Price - Quote by which a certain pair is being sold at that given moment

Bid Price - Quote by which that pair is being bought.

Spread - The difference between Bid and Ask price. It represents brokerage service costs and replaces transactions fees.

Long - It is process of buying a certain currency when the price is low in order to push the price to a higher price

Short - It is the process of selling a currency when the price is high with the hope of getting it to a lower price.

PIP (Percentage in Point) - This is the smallest unit of a currency pair. For example, EUR/USD is priced at 1.1555, the fourth decimal in this case 0.0005, is known as the PIP. If this pair moves up by 1 PIP, in this case 1.1555, you add 1 to the 4th decimal point (1.1555+0.0001), which will then give you 1.1556.

Lot - This is the standard size of a contract for trading. Lots are broken down to Standard (100,000 units), Mini (10,000 units) and Micro (1,000 units).

Margin - This is collateral a trader deposits with the broker when he/she executes a trade to hold a position open.

Margin Call - Request by the broker to the trader to top up his margin account when it falls below the minimum accepted level.

Leverage - It is the amount of money borrowed from a broker as capital to increase the potential return on investment. For example, if your account has 1000 dollars and request a leverage of 1:100 you will be able to control currencies worth 100,000 dollars.

Market execution - It highlights the different type of executions in the market when entering and exiting a trade.

Market Order - It is a type of execution to the broker to buy or sell a currency at a current quote, also known as instant execution.

Limit Order - This is a type of pending order. It's a type of execution to the broker to buy or sell a currency at a future price quote. It is sub divided into sell limit order and buy limit order.

A buy limit order can only be executed at the limit price or lower, and a sell limit order can only be executed at the limit price or higher

Stop Entry - It's the opposite of Limit order. It is an order to enter the market at a less favorable price.

When buying a currency pair, the stop entry will be placed above the current market price. When placing an entry order to sell, the stop entry order will be placed below the current market price.

Stop loss order - It is an Order to the broker to liquidate a losing trade at a pre-determined level.

Take profit - A take profit order is an order that closes your trade once it reaches a certain level of profit.

Take-profit orders are often placed at levels that are defined by other forms of **technical analysis**, including **chart pattern analysis and support and resistance levels,** or using **money management** techniques that will be highlighted later in this course work.

Premium - This is interest paid to or charged to the trader for holding currencies at Interest rate (I.R) difference. A good example is Swap.

Bullish – Characterized by rising prices in the market, this is simply an Uptrend.

Bearish – Associated with Falling Share prices in the market, this is simply a downtrend.

FOREX TRADING SESSIONS

In the beginning of the topic we indicated that the Forex market is open 24 hours a day. It provides a great opportunity for traders to trade at any time of the day or night. However, while it seems to be not so important at the beginning, the right time to trade is crucial.

The best time to trade is when the market is the most active under the four trading sessions namely; **New York Session, London Session, Tokyo Session, and Sydney Session.** London session has the most **volatility PIP movement**. Actively traded markets will create a good chance to catch a good trading opportunity and make profits. Below is a table showing Forex market time sessions:

Session	**Starts (GMT)**	**Ending (GMT)**
New York	**1.00pm**	**10.00pm**
London	**8.00am**	**5.00pm**
Tokyo	**12.00am**	**9.00pm**
Sydney	**10.00pm**	**7.00am**

DEMO TRADING VERSUS LIVE TRADING

New traders tend to start their trading journey with a Demo account**. A Demo account is an account that has virtual money and is used to trade the financial markets.**

Using a demo account is a convenient and practical way to learn the basics of trading. There is no real monetary risk when trading a demo hence you will find very minimal emotions attached to your trades and no risk management game play. There's also minimal capital constraints since demo trading generally allows the trader to choose the amount of capital he or she would like to work with.

The amounts vary, but are often very large and beyond the actual capital the trader has for trading their own account. **A demo account is efficient in back testing your strategies and basically understanding how the forex market works**.

Here at Financial Hub we do recommend beginning traders to start of trading on a demo account, this is not only vital to consolidate the right knowledge and strategy, but also helps in understanding how the forex market works.

When you come to the live account it's a whole different mind game. This is because most traders experience a psychological block, which can be very strong and distracting. During real-money trading, the emotions put into play are quite different.

Fear, greed, insecurity, and sometimes the basic thought of losing hard-earned money makes us make some questionable decisions. Almost everybody is emotionally attached to money and success and that attachment marks the origin of all the trouble.

Many traders, especially at the beginning of their careers, see the forex market as a tool to make easy money, and don't consider the risk of losing.

Traders who are considering trading forex as full-time job must take into account that a solid percentage of their trades will have negative results; we cannot expect to gain from every single trade.

For this reason, maintaining a good risk-to-reward ratio is one key element for a long-term successful trading strategy such that a single emotional trade won't affect us too much when we look at the long term results. Before taking the leap into real trading, make sure you have a plan for all types of market conditions.

In the following video you can watch precisely, the **differences between trading demo and live accounts:** (https://www.youtube.com/watch?v=QW2-C1SaVFo)

TYPES OF MARKET ANALYSIS

There are different forms of analysis that traders need to be familiar with so as to trade the forex market successfully, we will therefore introduce you to this different forms and show you how to use them in the market.

- ***Technical Analysis***
- ***Fundamental Analysis***
- ***Mental Analysis***

Technical analysis involves **study of historical price movement to determine where a given currency may be headed.**

Traders who use technical analysis will tend to focus on the **behavior of price action,** studying patterns that are formed in the markets. Technical analysts believe that the **behavior of price action** can give us probabilities of where the market is headed.

Fundamental Analysis is a **method of analyzing financial statements with the purpose of price forecasting.**

Forex fundamental analysis focuses on the overall **state of the economy, and researches various factors including interest rates, employment, GDP, international trade and manufacturing, as well as their relative impact on the value of the national currency they relate to.**

For example, a trader conducting a fundamental analysis of the **EUR/USD currency pair** would find information on the interest rates in the Eurozone more useful than the recent behavior of price action on the pair**.**

Mental analysis is also called the psychology of trading, under this topic we get to discuss some of the **mind techniques** that are useful for performance while trading the **forex market.** Trading is a game that involves **constant feedback**, your level of success and improvement will be directly pegged to how good you are in handling **adversity, managing emotions and dealing with uncertainty.**

BEGINNER'S GUIDE TO TECHNICAL ANALYSIS

AN INTRODUCTION TO TECHNICAL ANALYSIS

What Is Technical Analysis? Technical analysis is a method of evaluating price of an asset by analyzing the statistics generated by market activity, such as past prices and volume.

Technical analysts do not attempt to measure an asset's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns; others use technical indicators and oscillators, and most use some combination of the two.

In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts.

Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the asset might move in the future.

The field of technical analysis is based on three assumptions:

- **The market discounts everything** – technical analysts believe that everything that is important in determining the value is pegged into the price; therefore by studying price action we can be able to generate ideas.
- **Price moves in trends –** A trend can be defined as the general direction of something, technical analysts believe that prices will most of the time move in trends due to human nature.
- **History tends to repeat itself –** There is nothing new under the sun, only what you have not seen. In this field, we are staunch believers that whatever happened in the past will probably happen in the future.

BASICS OF TRENDS

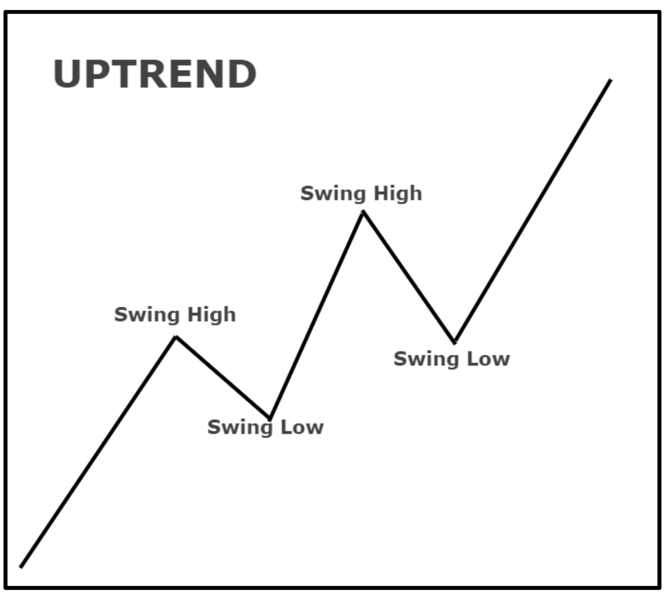
One of the most important concepts in technical analysis is that of the trend. The meaning in finance isn't all that different from the general definition of the term **- a trend is really nothing more than the general direction in which an asset or market is headed.**

Unfortunately, trends are not always easy to see. In other words, defining a trend goes well beyond the obvious. In any given chart, you will probably notice that **prices do not tend to move in a straight line in any direction, but rather in a series of highs and lows.**

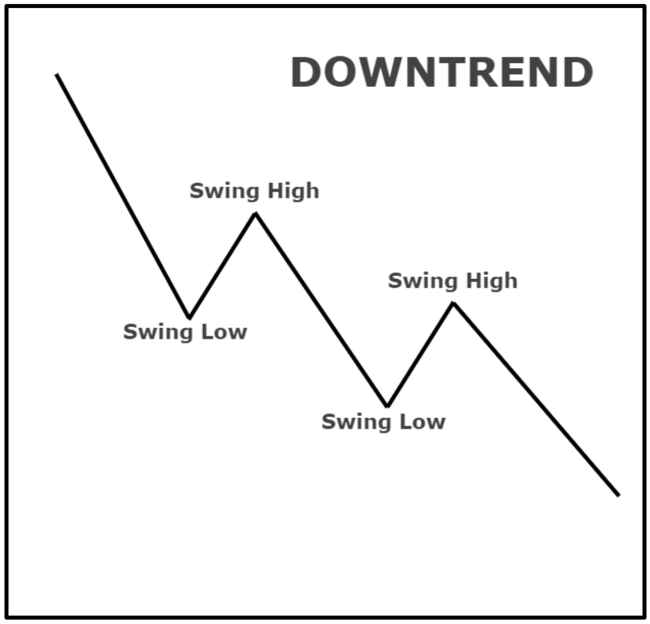
In technical analysis, it is the movement of the highs and lows that constitutes a trend. For example, **an uptrend is classified as a series of higher highs and higher lows, while a downtrend is one of lower lows and lower highs.**

TYPES OF TRENDS

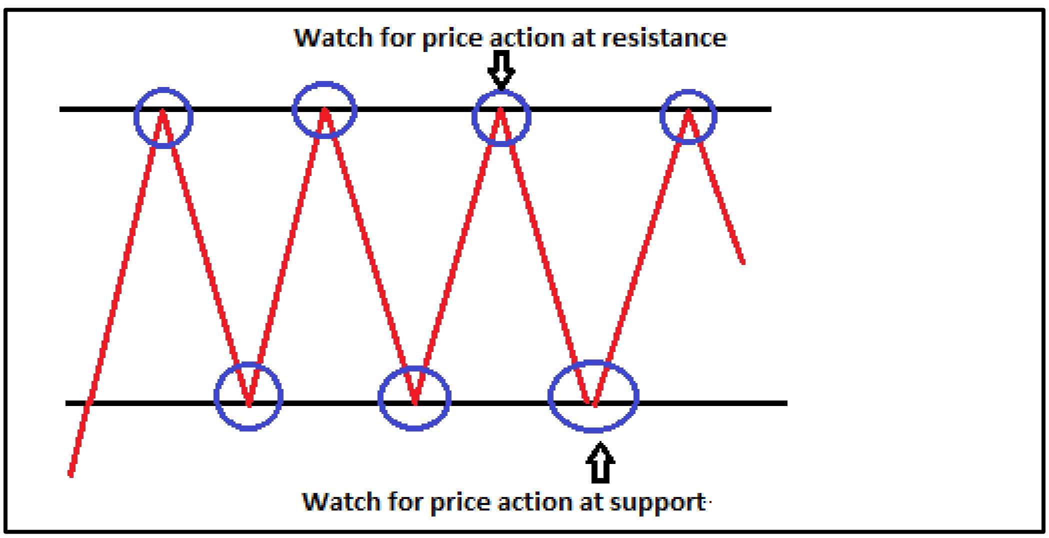
Uptrend- made up of a series of higher lows and higher highs in the forex market.



Downtrend- made up of a series of lower highs and lower lows.



Sideways Trend- made up of a series of equal highs and equal lows.



As the names imply, when each successive peak and trough is higher, it's referred to as an upward trend. If the peaks and troughs are getting lower, it's a downtrend. When there is little movement up or down in the peaks and troughs, it's a sideways or horizontal trend.

If you want to get really technical, you might even say that a sideways trend is actually not a trend on its own, but a lack of a well-defined trend in either direction. In any case, the market can really only trend in these three ways**: up, down or nowhere.**

Along with these **three trend directions,** there are **three trend classifications**. A trend of any direction can be classified as a **long-term trend, intermediate trend or a short-term trend.**

In terms of the forex market, a **major trend is generally categorized as one lasting longer than a year.**

An **intermediate trend is considered to last between one and three months and a near-term trend is anything less than a month.**

A **long-term trend is composed of several intermediate trends, which often move against the direction of the major trend.**

If the major trend is upward and there is a downward correction in price movement followed by a continuation of the uptrend, the correction is considered to be an intermediate trend. The short-term trends are components of both major and intermediate trends.

We have now introduced you to the concept of technical analysis and explained the meaning of a trend which is one of the most important concepts under this field. We will now dive into individual technical tools introducing you to how we use these technical tools, and why it is important to have them in your charts.

We will therefore break down the tools and show you how you use the tools by combining them, consider this **a basic guide into not only understanding tools but understanding the thought process of a technical trader.**

In your process of learning these tools, constant and consistent practice will be emphasized. This is because the mind only learns through repetition; one should therefore ensure his practice is rich and effective.

LINE GRAPH, BAR CHARTS AND CANDLESTICK CHARTS

In the beginning of your journey to chart analysis I'm sure some of you have heard the phrase that trading is **both an art and a science**, from our understanding science comes in when choosing & developing your chart type and layout but the art is how you decipher and act to the information your charts present to you.

Technical traders are different from fundamental traders; fundamental traders who are mainly large financial institutions analyze economic data to come up with investment decisions while technical traders analyze price movements and market patterns to help them speculate market movements. None has power over the other. In this section we'll focus on technical charts to help you understand how the market works and how to benefit from this style.

Charts simply show factored fundamental data in form of price and convey to technical traders the past, present and future market direction; simply the overall market picture. There are so many chart types used to analyze the markets but we'll only explain to you three chart types:

1. **Line Chart.**
2. **Bar Chart.**
3. **Candlestick Chart.**

LINE CHART

Line chart is the simplest of all charts to understand because they only show sequential closing prices of the subjected instrument/market using a line on the chart.

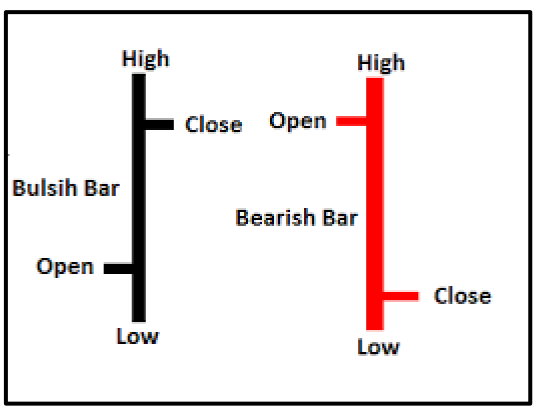
It's beneficial because it maps out the price movements in a tidy way, silences the market's price extremes or choppy behavior, identify chart patterns and can help traders find significant support and resistance levels.

It carries one disadvantage though, you can't know what happened in a single session but you can know who won the battle through the closing price.

From the chat below, it is quite evident that it's really hard to make any deductions from the following chart, we therefore don't advocate using of this charts in your technical breakdowns.

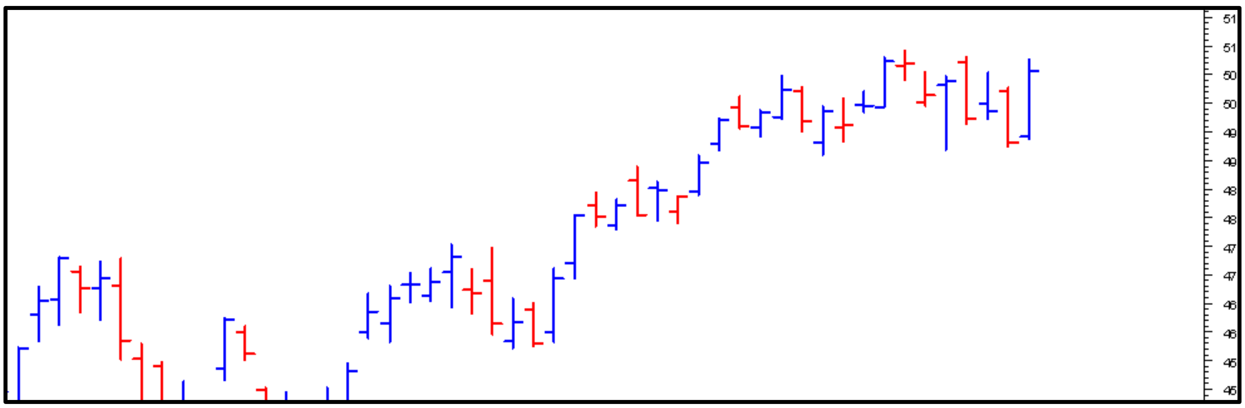
BAR CHART

Bar charts provide us with more information compared to line charts, how? They indicate a **time-frame's/market's open, high, low and close** on a vertical bar.



On the **bar's left hand side** is a tiny horizontal line that indicates the **opening price** while the tiny **horizontal line** on the **right side** indicates the **closing price**. The **height of the bar** represents **price range of the highlighted time-frame**, the **high** represents the **highest price** and the **low** represent the **lowest price.**

Traditionally bar charts used to be black and white, white bars representing a rise in price while black bars represent a drop in price from previous time-frames but as trading advanced different platforms introduced different colors; **green and red being the most common ones.**



We also don't use this charts for any analysis, because we believe candlestick charts are better for Analysis.

CANDLESTICK CHARTS

Candlesticks have been named the first concept because most traders will use candlesticks to generate market information in relation to price action. Candlesticks basically display the same information as bar charts but in a more appealing way.

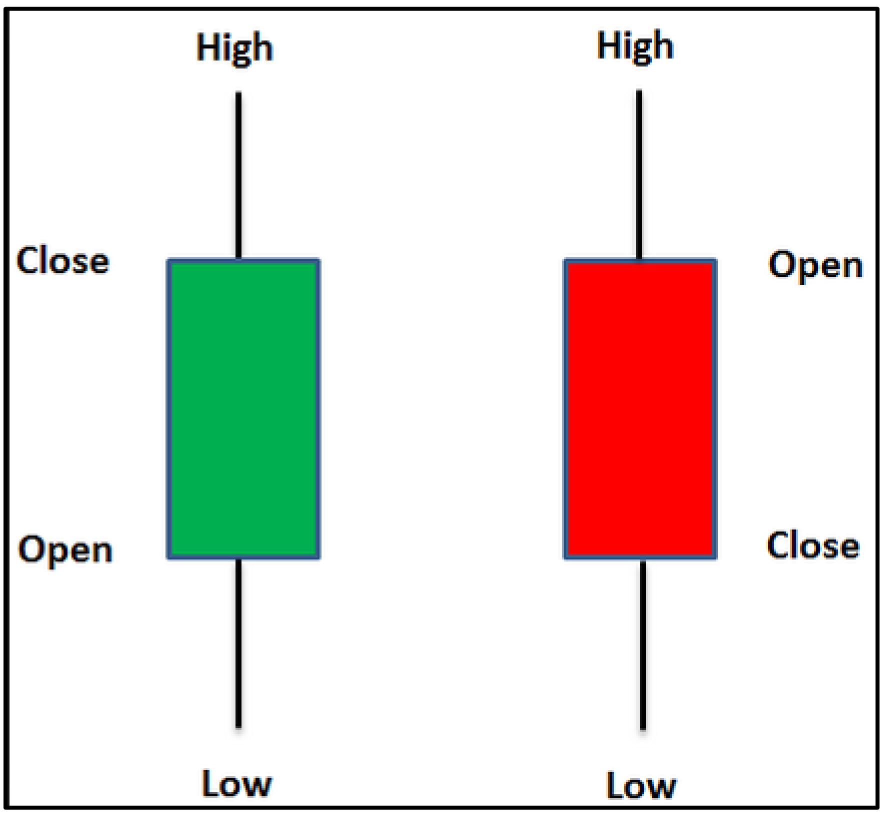
They indicate the **high and lows** of a given **time-frame** using vertical lines known as **'wicks' or 'shadows'** that appear on top and below of the block structure.

Candlesticks differentiate themselves from bars through **opening and closing price range**, candlesticks display the **opening and closing range in form of 'block-like'** structure known as the **candle body** which appear in different preferential colors depending on the **closing price** compared to the **opening price.**

Green and red are the most common/basic colors for candlestick, **green candlestick indicate that in a particular time-frame the closing price is above the opening price; termed as bullish** while **red is the vice-versa and it's termed as bearish.**

Candlesticks often appear in **different sizes**, **large candle bodies** indicate **strong price movement** while **short candle bodies** indicate **market indecision between buyers and sellers.**

We will therefore go ahead to look at various candlestick patterns and what they mean for the markets:



The image below is an illustration of both a **bullish and bearish** candle respectively

SINGLE CANDLE LINES

SHOOTING STAR AND PIN BAR

These two candlesticks are **popularly known for stop hunting.** That's why in some trades I don't use a tight stop or automatic stop. Instead I choose to watch price action and see what will happen.

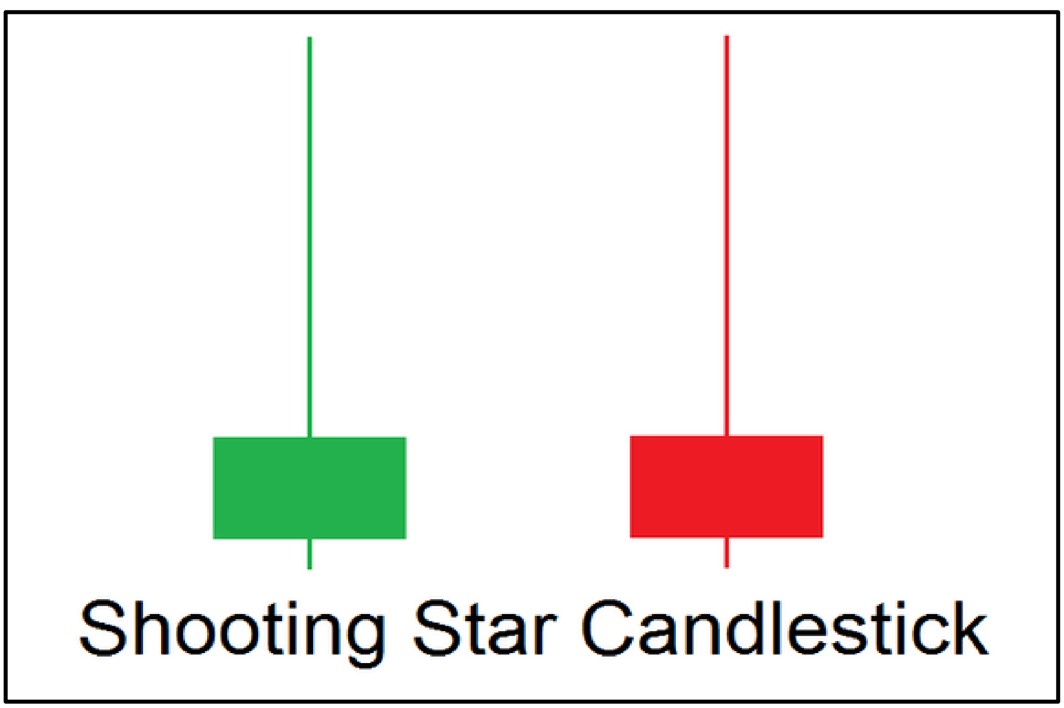
SHOOTING STAR

It is formed when **prices open higher, but go down closing substantially lower being unable to close above a certain level. It's a very strong reversal signal and especially on major key levels.**

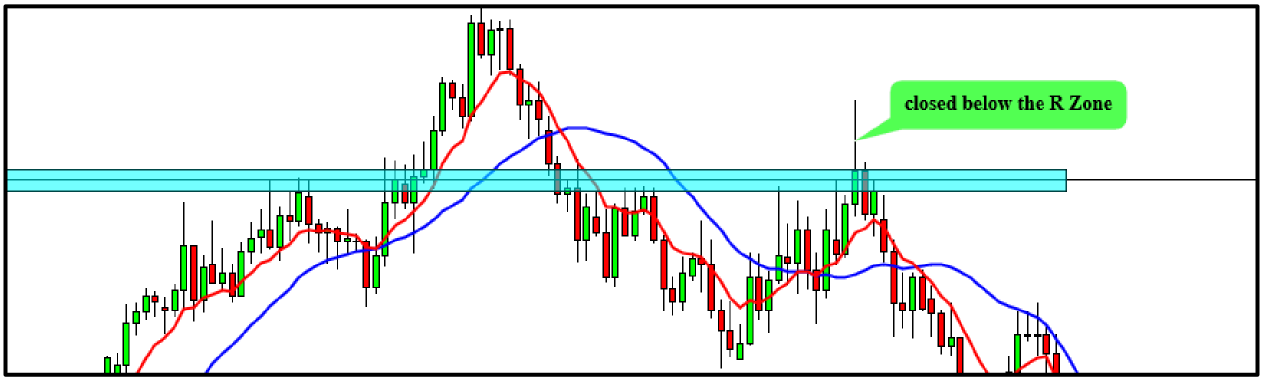
It is observed after an uptrend, mainly at **resistance areas.**

It's mainly seen as a good reversal sign on key Fibonacci levels and on the key levels (Resistance).Always wait for the candles that come after it has formed for further confluence

The following is a representation of a shooting star candlestick.



The following is the effect of the candlestick on the charts**: we can observe how price traded higher during the session but towards the close it trades lower closing below the resistance zone. The candlestick that follows confirms a short bias.**



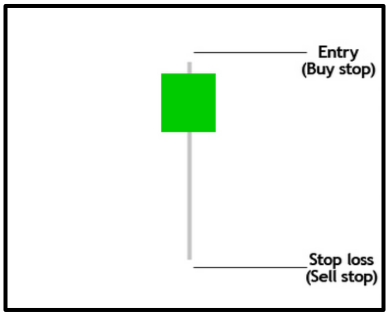
PINBAR

This formation is mainly the same only that it's observed mainly on **support areas.** It is formed when prices **open lower but as the session is closing prices rally back up signaling a lot of buying pressure coming into the market.**

When it occurs after an extended downtrend and at a crucial support area it's a better signal.

The same rules that apply to the shooting star apply when executing trades based on this candlestick

The following is a representation of a pin bar candlestick:



The following is a potential trade that could be executed and result in profit based on a pin bar candle: observe how a **bullish engulfing candle** is formed immediately after formation of the pin bar, confirming **bullish bias.**

DOJI

Doji are known as danger signs when they are seen after an **uptrend or downtrend.**

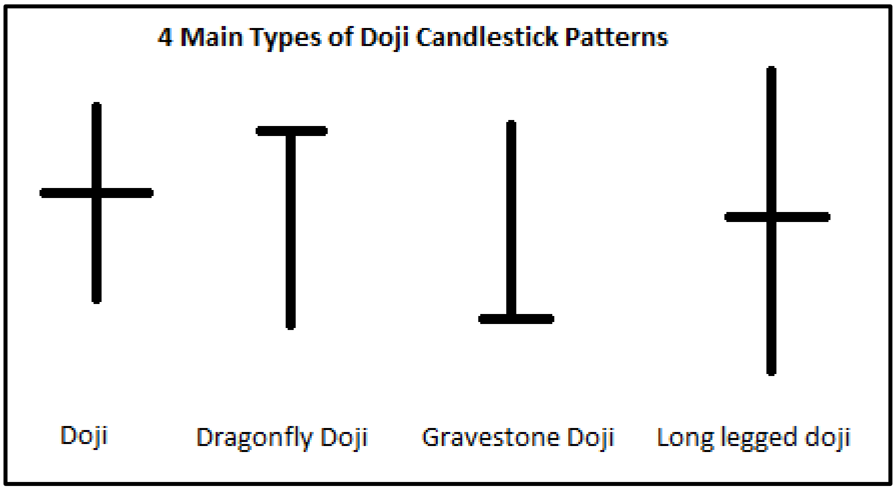
It's a very strong reversal signal and especially while using the top down approach of trading the markets.

Doji has no real body.

There are 4 types of doji:

1. **Grave stone doji**
2. **Long legged doji**
3. **Dragons fly doji**
4. **Four price doji**

The following is an illustration of the types of doji candles:



GRAVE STONE DOJI

This candlestick Is a strong bearish indicator, it starts when the open implies that buyers pushed prices higher then sellers stepped on orders pushing the prices back lower as the session was closing.

Occurs **rarely** but gives even clear signal of some **bearish momentum** in place.

LONG LEGGED DOJI

The candlestick is formed when closing prices are equal despite fluctuations throughout the day.

This candlestick is a formation which mainly **indicates balance of power between the buyers and sellers.** It **shows indecision** in the markets.

But always remember that doji is a main reversal pattern, so once you have seen it you better be ready or prepare for some reversal especially on key levels.

But once you have seen it among some group of some high wave candles then you can wait for the reversal to take place.

This candlestick is a **show of stalemate** between **supply and demand.**

DRAGONS FLY DOJI

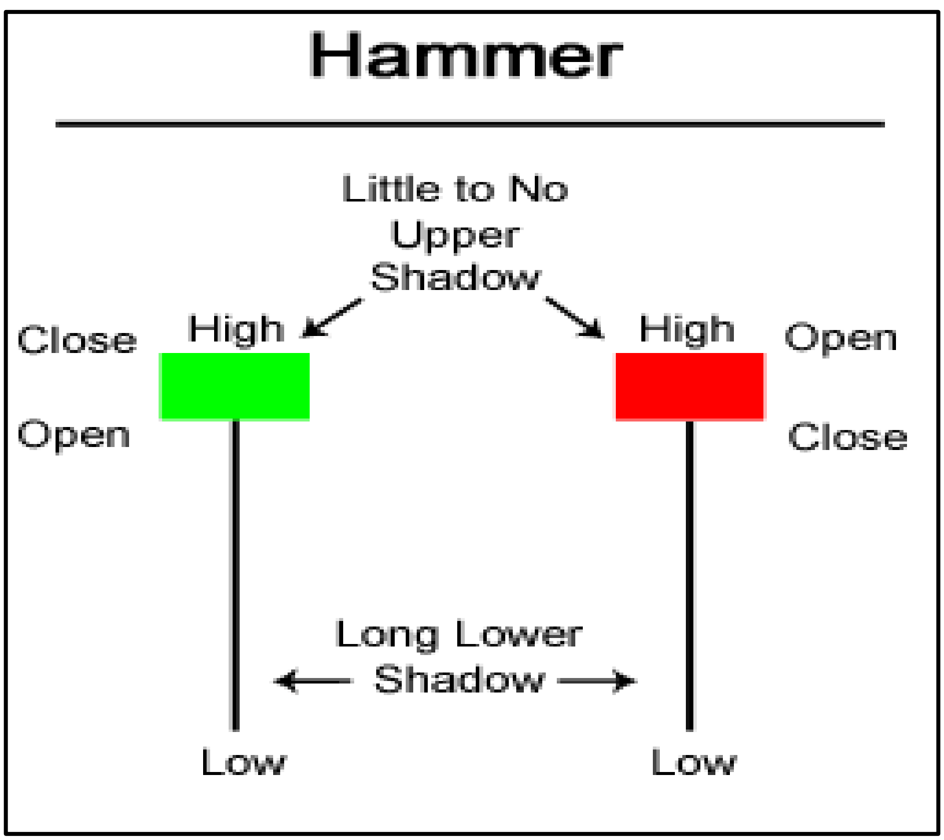
This **candlestick starts the session with the prices going lower and before the session closes prices are pushed back up closing back up**.

This indicates that sellers opened the session with enthusiasm but once the session was closing buyers stepped on orders hence causing prices to be pushed back up.

If you happen to see this candlestick on the support especially one using the top down approach of investing you should be ready to set some buy orders at the support especially after confirmation of the shift in momentum.

HAMMER AND HANGING MAN

The following is an illustration of both candlesticks. They look the same only **differ on point of appearance.**



HAMMER

It's **formed when prices trade lower during a session but later rally back closing near the opening price or at the opening price, marks reversal of a bottom or of an important support level.**

Candle shows that buyers have seized control.

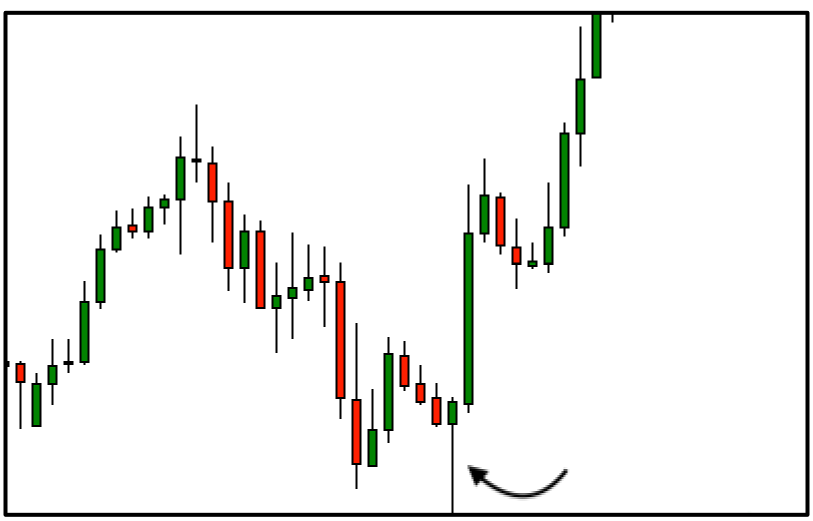
The candle should appear after a **significant downturn** in an **oversold market** to have significance and for the setups to be fulfilled.

Color doesn't really matter, but if the candle is green it indicates more **bullish momentum and confirms the reversal.**

There could be a possibility of some selling rally to go back to test the support.

The following is an example of a chart and **the aftermath of what followed after the formation of the hammer:**

The hammer formation confirms the polarity of the support zone.



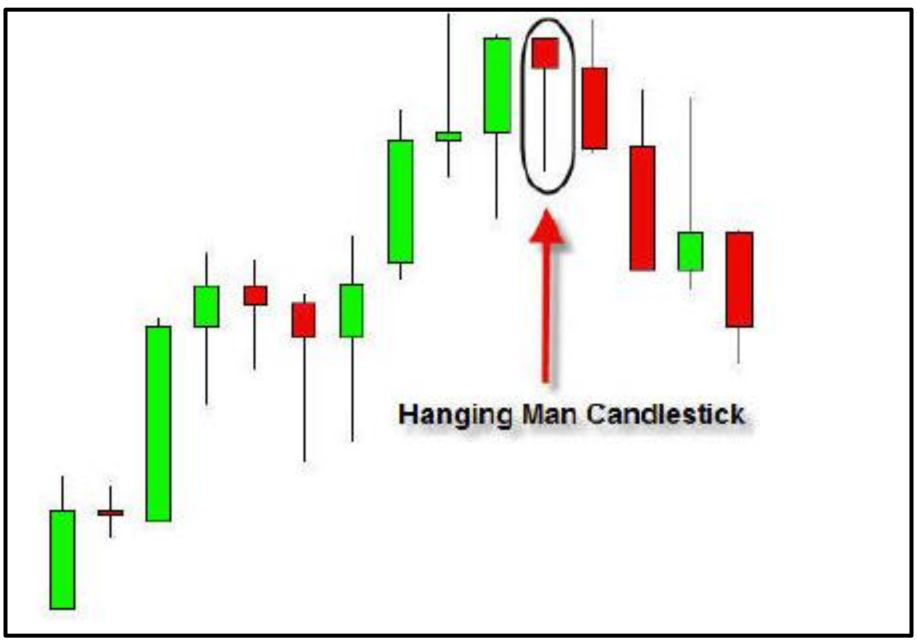
HANGING MAN

Basically same as hammer only that it appears in areas of **resistance mainly.**

There should be some more **bearish confirmation** (wait for the next candlestick close) for you to make a decision.

For this candlesticks to materialize always look at the prior trends. Remember they must act as reversal signals; therefore price has to have been in an uptrend for this candlestick to make more meaning and be more accurate.

The following is an illustration: it is mainly formed among many indecision candles on the resistance zone resulting in consolidation before meltdowns**.**



TWEEZER TOPS AND BOTTOMS

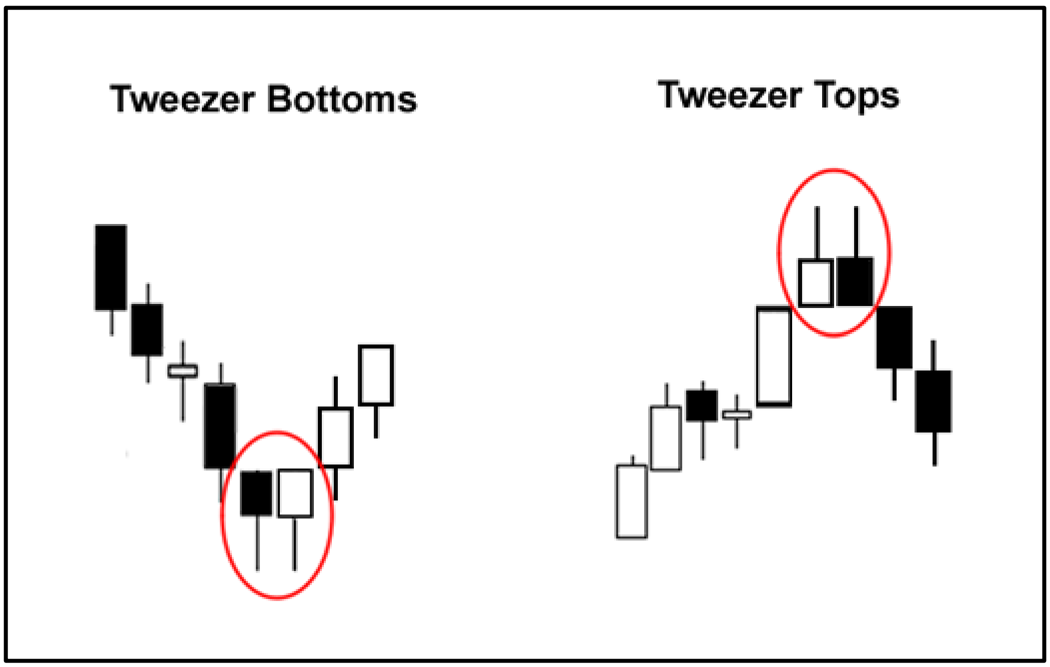
This is a **candlestick pattern that involves two candlesticks which close at the same level and open at the same level, they simply match highs and lows.**

The two candlesticks must not be the same color; in fact the candlestick should have different colors.

Take major importance when they occur after an extended move, this could signal a potential reversal.

Markets should not close above the level for the pattern to be validated

The following is an illustration of each candlestick after its formation:



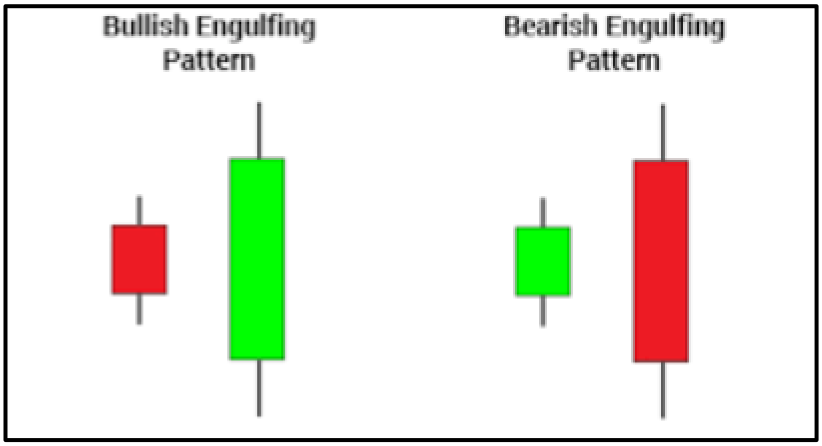
DUAL CANDLE LINES

BULLISH AND BEARISH ENGULFING PATTERNS:

These are two major candlesticks which bear different colors.

They are better and have more weight when they occur on the **weekly** and **daily** key levels.

The following is an illustration:



BULLISH ENGULFING PATTERN:

This is a candlestick pattern that is a major reversal signal.

It usually occurs at areas of support after a down trend or bear market.

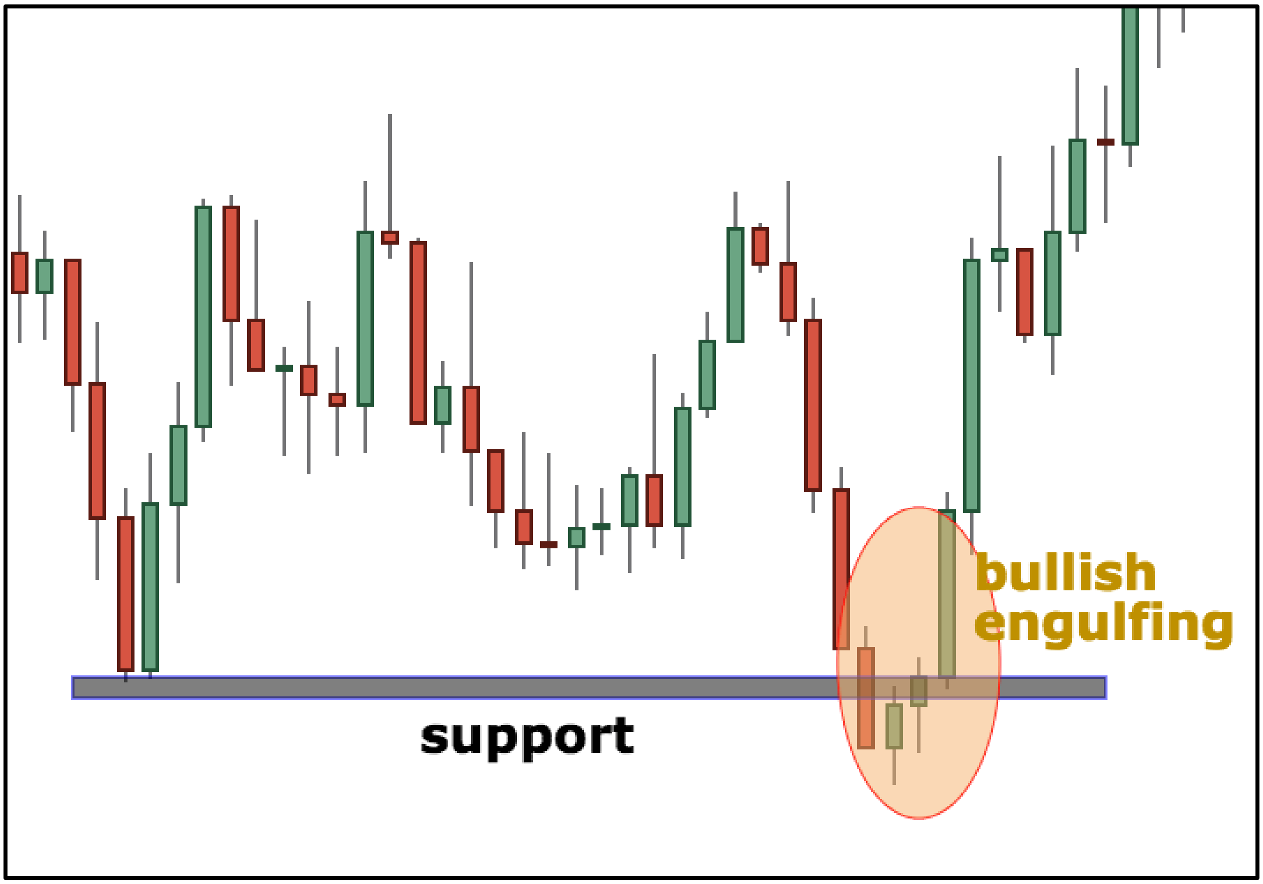
It comprises of two candles the 2nd candle engulfing the first candles real body.

The bigger and the stronger the engulfing pattern the more momentum is behind the move causing the move to be more significant.

Also it is important to check how many candles have been engulfed and the colors of the two candles have to be different.

It's not important if it engulfs the wicks of the preceding candles.

The following is an example of the candle pattern:



BEARISH ENGULFING PATTERN:

It's the opposite of **bullish engulfing pattern** only that now it occurs in the areas of **resistance.**

It's a strong indication of some strong bearish momentum.

The same rules that apply to the bullish engulfing apply to this pattern.

The following is an example of the bearish engulfing:

SUMMARY

We have gone through the concept of candlesticks, and introduced you to several candlestick patterns. It is our hope that you now understand the formation of a candlestick and you can be able to interpret the information that the candlestick communicates.

We also want to warn you that we have not covered all candlestick patterns comprehensively; you should therefore take the time to dive deep into the topic.

We will now move to the next technical tool and concept: **support and resistance.**

KEY LEVELS (SUPPORT AND RESISTANCE)

The concept of supply and demand has been the building block of capitalism. In every free market, **when supply overwhelms demand then prices will fall and when demand overwhelms supply then price will rise.** It is this relationship between **prices, supply and demand** that results to the formation of key levels.

In Financial markets, this same concept will apply which ever asset you are trading. The basic rule of **"Buying Low and Selling High" is built on this principle.**

This means that **when prices are low, then majority of traders must be sellers and minority will be buyers.** The opposite scenario applies when prices are high, at this point majority are buyers pushing the prices high. In order to benefit from this rule, we must always strive to join the minority side in the markets.

The **concept of supply and demand** is what will enable forex traders to map out **support and resistance levels** within a trend which enables traders to benefit especially in **timing entries and exits in the markets.**

Markets will **always move up, down or sideways.** This simply means that **markets will trend and at times they will range.**

It is through our understanding of the market structure that we will be able to identify what is going on in the markets.

In a **trending market** we will get the **formation of higher lows and higher highs** if the market is **trending upwards.** In a **down trend,** the markets will form **lower highs and lower lows.**

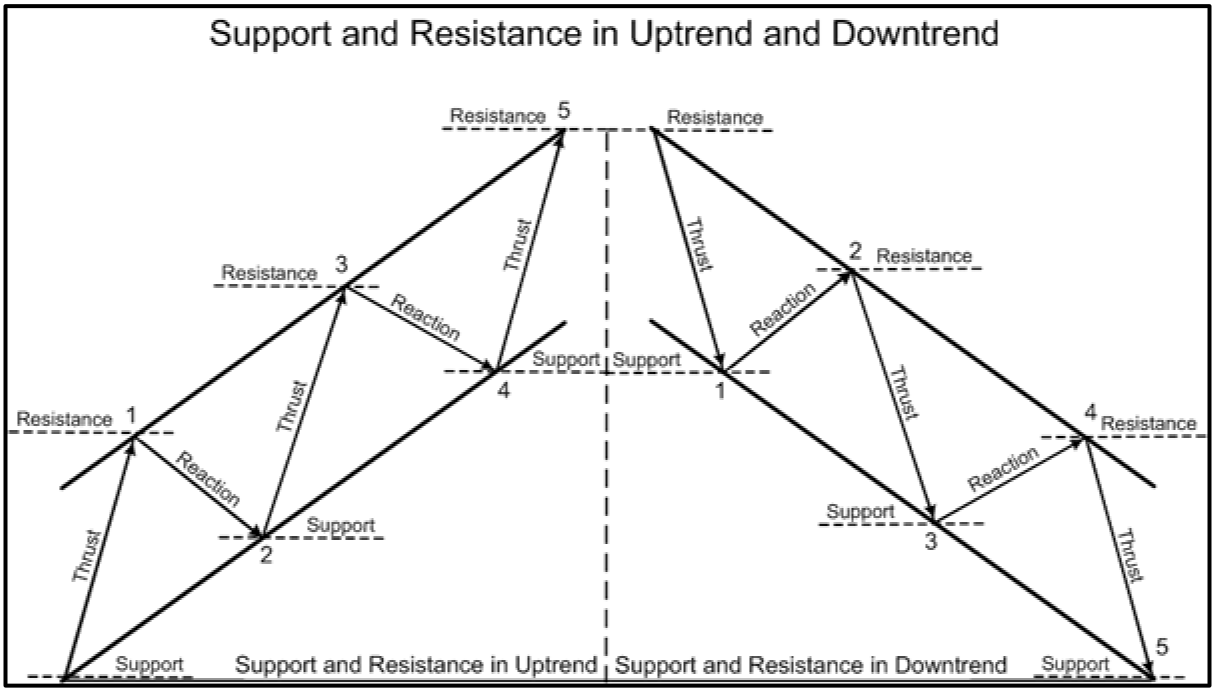
It is this **pattern formation that results to the formation of demand zones and supply zones in the markets.**

The **demand zones** are generally called **support** while the **supply zones** are called **resistance.**

Support can be easily defined as a point where a bear market has stopped and bounced higher.

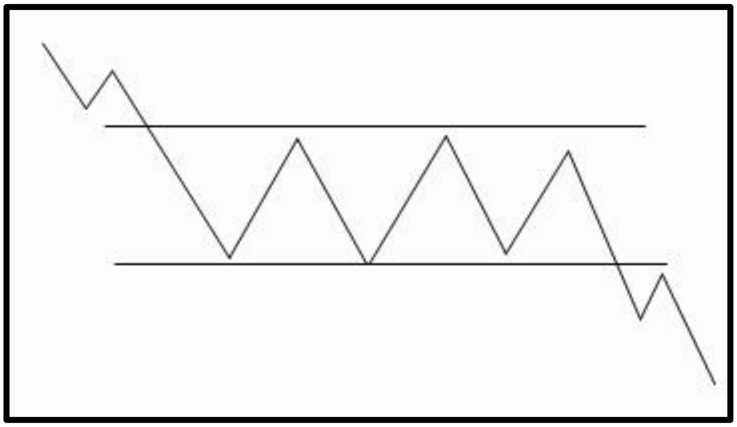
Resistance on the other hand can be defined as a point where a bull market has stopped and moved lower.

The following chart can serve as a good illustration to explain these concepts:



The image below clearly represents an **Uptrend and a downtrend,** in the case of an uptrend we have the formation of **higher lows** and **higher highs** which result to the formation of **Support and Resistance Levels.**

In the Case of a **downtrend**, the **reverse scenario** would be the case meaning we would have **support levels replacing resistance levels** and **resistance levels replacing support levels.**



The **image** below represents the **support and resistance levels** in a **ranging market.**

Forex traders must learn to identify these areas **(Key levels)** especially since this is the building block of **technical analysis.**

We will go ahead to show you these levels in a real candlestick chart,

The following is a USDCAD daily chart with the key levels marked; from the illustration below it is quite clear, that by marking the key levels I could be able to anticipate market movements and understand partly why the markets are behaving in a certain way.

Currency markets can be easily understood using **only technical analysis;** this is due to the **huge liquidity, speculation capital and volume being traded on a daily basis.** This means that currencies will tend to respect levels and especially if you have marked the levels accurately**.**

It is important to remember that when we talk about key levels, we don't talk about a one price target, we tend to look for a zone of maybe 30 to 40 pips and map that as a demand or supply zone depending on the underlying trend.

Key levels will exist because of two reasons**, one is emotional attachment and the other one is memory.** Apparently, the memory of a particular level will be remembered or forgotten easily depending on how price action struggled to break past that level and whether we had a complete change in the direction of the trend in the markets.

MAJOR AND MINOR LEVELS OF SUPPORT AND RESISTANCE

The different levels **of support and resistance** will have different weights and importance in the currency markets.

Major levels of support and resistance are the levels where we had a change in trend direction; this means that these levels are very important for traders as they signify which zones to look for when the markets are changing direction.

Minor levels will show us the zones where we expect pullbacks and retracements to come into the markets before we have a trend continuation in the markets. A trend continuation will demand that traders map out the next level they expect to be hit in the markets.

Traders should therefore understand the difference between these two levels, in marking of your levels to ensure you get the accurate major and minor levels, it is important to use the top down approach. This is a concept we have gone through in our professional and legendary packages.

LEVELS AND ROUND NUMBERS

The best levels to use in the markets are the round numbers, this is because humans will tend to remember the round figures and are more emotionally attached to those levels.

The round numbers we are talking about can be like 1.300 on the GBPUSD pair. To understand this further, think about the price of items. When an item is priced at 999, people will tend to round it up to 1000. This is how we build the association between levels and round numbers.

SUMMARY

We have introduced you to the concept of support and resistance; the beginner should therefore take time to learn how to mark the levels. This is well covered in our professional and legendary package.

It is important to understand this concept because much of the game of technical analysis is to understand the metrics of **supply and demand.**

You can check out our YouTube Channel to get a basic introduction to this concept: https://www.youtube.com/watch?v=e4c3cz3zSMM

We will now move to the next concept which is trend lines.

TREND LINES

Many traders are familiar with trading price action techniques **using horizontal support and resistance lines,** but some traders find it difficult to trade using trend lines, and this is rightfully so, since trend line analysis requires a little more discretion on the part of the trader.

Trend lines are very useful in helping you determine the trend, and also the strength of that trend as well. Today we are going to take a closer look at this important price action analysis technique.

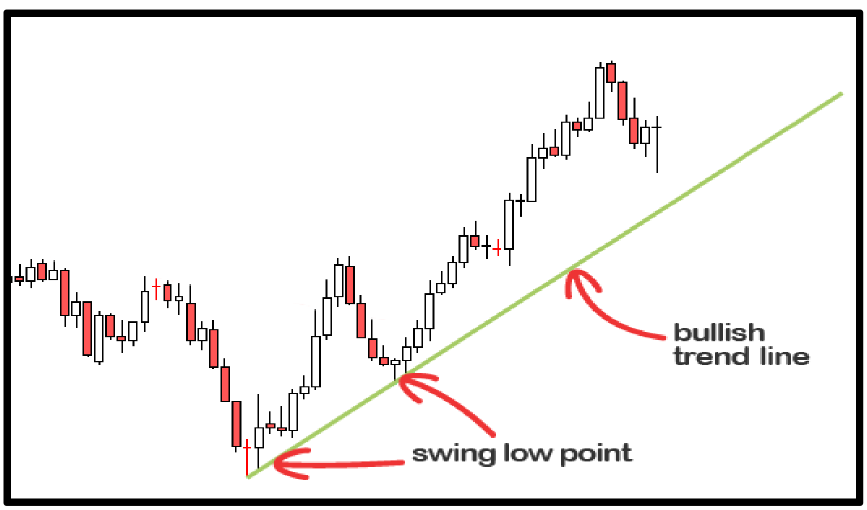
WHAT ARE FOREX TREND LINES?

Trend line analysis in Forex is a crucial price action method that helps us first and foremost in trend detection. **Trend lines** measure the price move of a Forex pair when the price is **increasing or decreasing**. In this manner, there are two types of trend lines:

BULLISH TREND LINES

We have **a bullish trend when the Forex pair is increasing**. In this manner, the price of the pair records **higher bottoms and higher tops.**

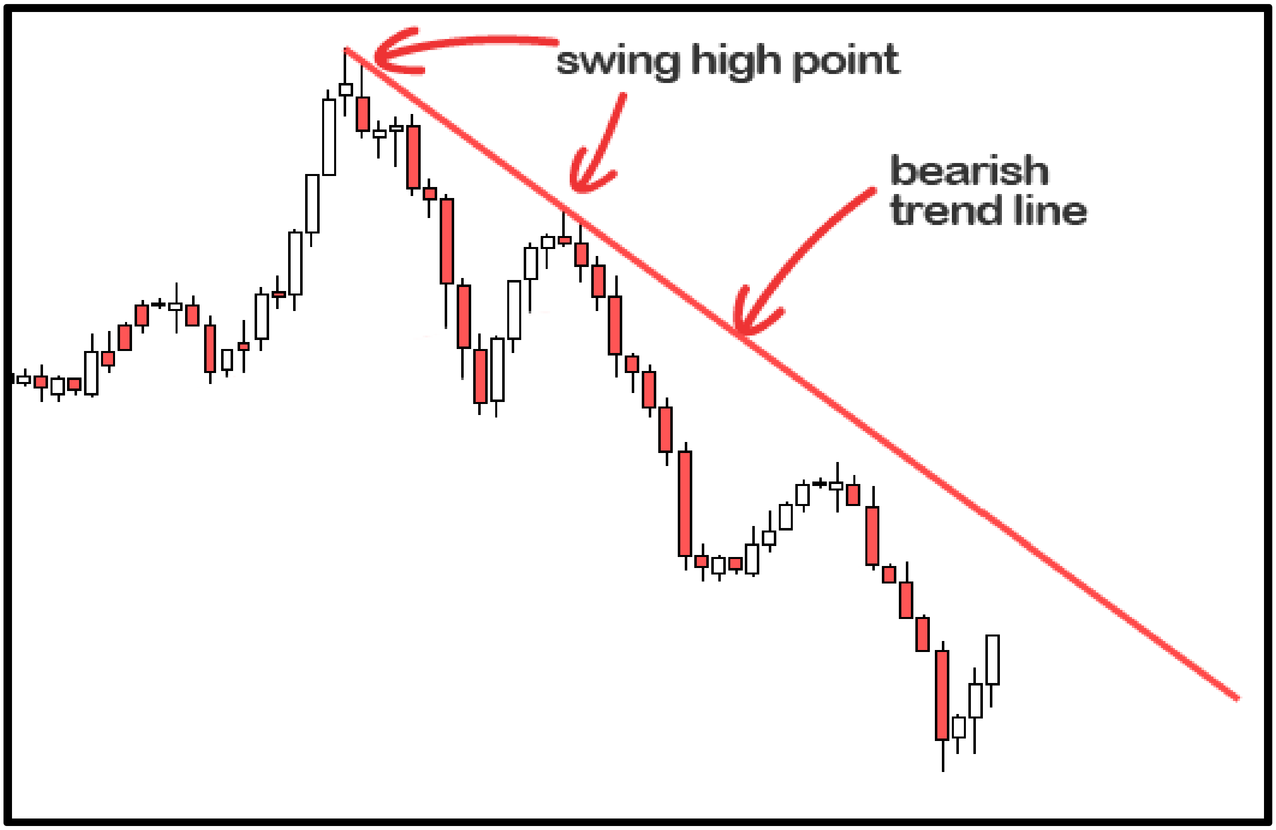
The bullish trend line should be located below the price action and it should connect the bottoms of the currency pair. This way the bullish trend line acts as a support for the price action.



BEARISH TREND LINES

The bearish trend has the opposite character of the bullish trend. We use a bearish trend line in order to measure the price action during a price decrease.

In this manner, the bearish trend requires the price to record **lower tops and lower bottoms.** This indicates that the price is dropping. The bearish trend line should be located above the price action during a price decrease. The bearish trend line plays the role of resistance for the price.



In order to draw a trend line (bearish or bullish), you first need to identify a trend.

Look at this chart below: On the chart below it is evident that the formation of higher lows and higher highs could signal to us the formation of an uptrend.

In order to gain a better understanding of how to draw trend lines, we must first recognize the composition of the typical candlestick. Every Japanese candlestick consists of five elements – **body, top of the body, bottom of the body, upper candlewick, and lower candlewick.**

We need to understand these elements in order to build a proper trend line. So**, if you want to build a bullish trend line, you need the spot the lower candlewicks and the candle body bottoms on the chart.**

Most times you would use the candlewicks to compose the trend line; however, you could use the candle body in instances where short term volatility spikes occur outside the normal range of the sloping trend line. Then, if the price is moving upwards, you connect these with a straight line.

THREE IMPORTANT RULES FOR DRAWING TREND LINES

In order to confirm a trend, you need at least three points lying on the same line!

When drawing trend lines, you must have a minimum of two points. In order to confirm a sloping support or resistance, you need a third confirmation point, lying on the same line as the two previous points.

Never think of the trend as contained within of a single line. The trend is not a line, but an area.

When you draw a bullish trend line you should take into consideration the lower candlewicks and the body bottoms. Very often the lower wicks of the candlesticks might go outside the scope of the trend line.

However, we know to think of the trend line as an area and not as a single line written in stone.

In this manner, if the price action breaks the trend line with its candlewick, this doesn't mean that the trend is broken.

An important point also to keep in mind is that as trend lines mature, there will be more of a tendency for price reactions at the trend line levels, and many times you will see false breakouts around these areas.

Trading trend line strategies will be a whole topic on our **PRO package** but here we will just highlight a few ways to use trend lines.

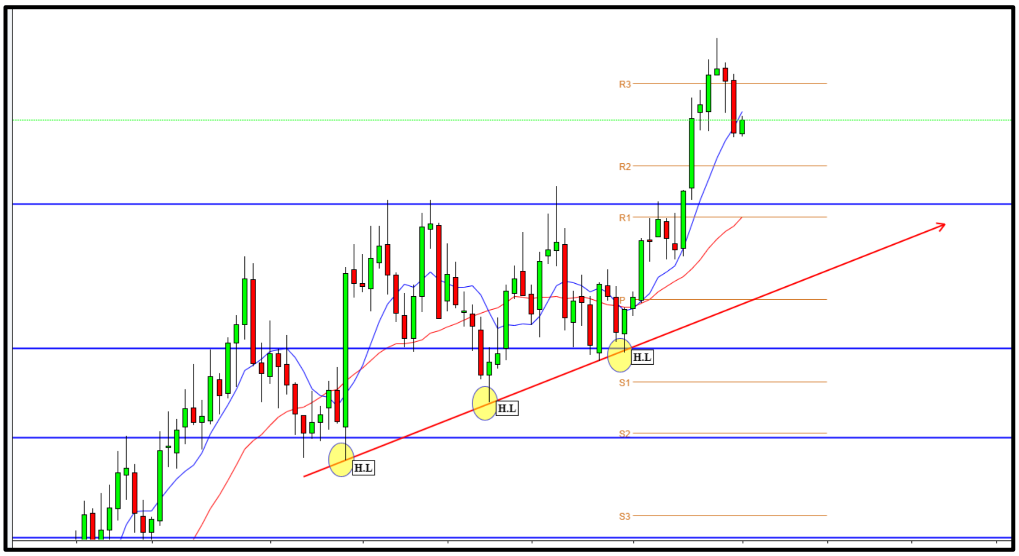
1. Trend line Bounce
2. Trend Line Breaks

To clearly understand this two uses, make sure to check out the following videos: https://www.youtube.com/channel/UCGZ595tFkjl4UOH3S9_GQ7Q/videos

TRENDLINE BOUNCE

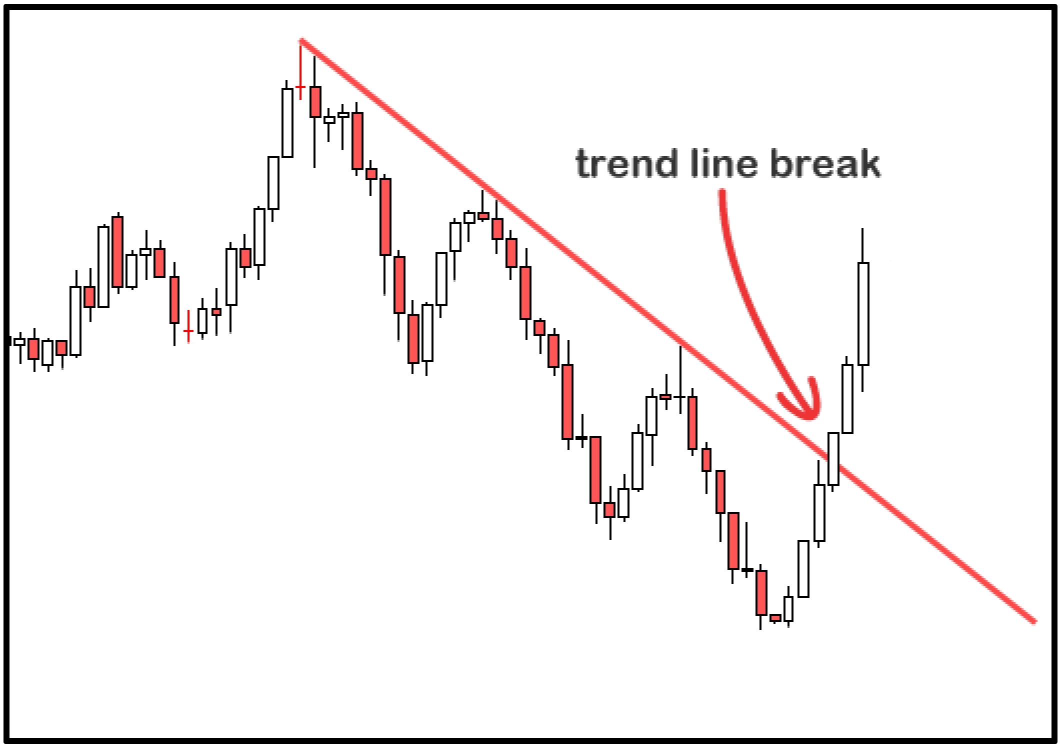
As previously discussed, trend lines can be used as areas of support or resistance. Price action will always respect these levels and traders usually step up orders when it comes to trading these areas.

When trading the trend line bounce we want to identify an opportunity on the 3rd or 4th point of bounce on a correctly and accurately drawn trend line**.**



TRENDLINE BREAK

Trend line breaks, as the name suggests, occur when the market breaks the trend line instead of bouncing off it. They act as a good sign of a reversal of the underlying trend. Trend line breaks are some of the set ups which will often offer very good risk reward ratios. This is because they offer an opportunity to place tight stops and get nice projected targets.



SUMMARY

Remember these three important rules when you analyze potential trends:

You need at least three points lying on the same line in order to confirm tendency.

The trend line responds to an area and not to a single line on the chart. We will now dive to the next topic which is Fibonacci Concepts.

FIBONACCI RATIOS

“Learn to see how everything connects to everything else”

Leonardo Pisano also famously known as Fibonacci was the one who discovered that there was a sequence of patterns in the world. He was born in **1170** in **Italy.**

Fibonacci came from the field of mathematics, Fibonacci ratios follow a sequence of numbers and ratios that are often found in nature **e.g. uncurling of a flower.**

Everything in the universe is constructed geometrically using Fibonacci, Fibonacci sequence – construct nature and physical make up of human body**.**

When you add the previous number and the current number you get the next number: **e.g. 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89 and 144……………………………………….**

The further ahead you keep dividing the 2 numbers after each other respectively you get the golden ratio e.g.

2 divide by 1 = 2

3 / 2 = 1.5

5 / 3 = 1.667

8 / 5 = 1.6

13 / 8 = 1.625

21 / 13 = 1.615

34 / 21 = 1.619

55 / 34 = 1.618

89 / 55 = 1.618

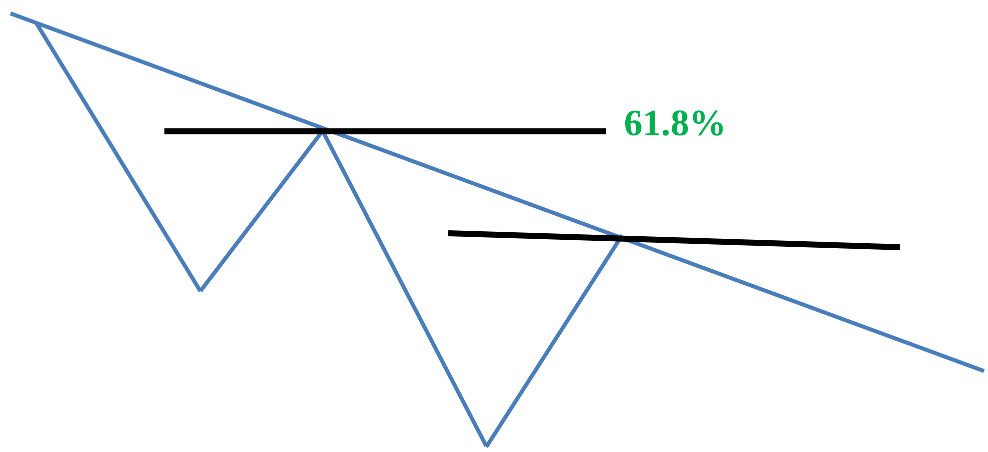
144 / 89 = 1.618 …

The 1.618 is known as the golden ratio. When you do the reciprocal to this number you get 0.618. This level also known as the **61.8%** is one of the retracement levels used by many traders to get entry points in the markets.

<u>PERCENTAGE OF VALUES WHICH ARE MAINLY USED FOR RETRACEMENTS</u>

1. 38.2% - strong trend, fast pull back bounce.
2. 50% - medium trend widely monitored.
3. 61.8 % - golden ratio.
4. 78.6% - weak trend and sign of reversal.

Examples shown: The following is an example of a golden ratio retracement with a series of lower highs in formation.



Fibonacci is also one of the most commonly used set ups by traders to get trade set ups and make profit in the markets.

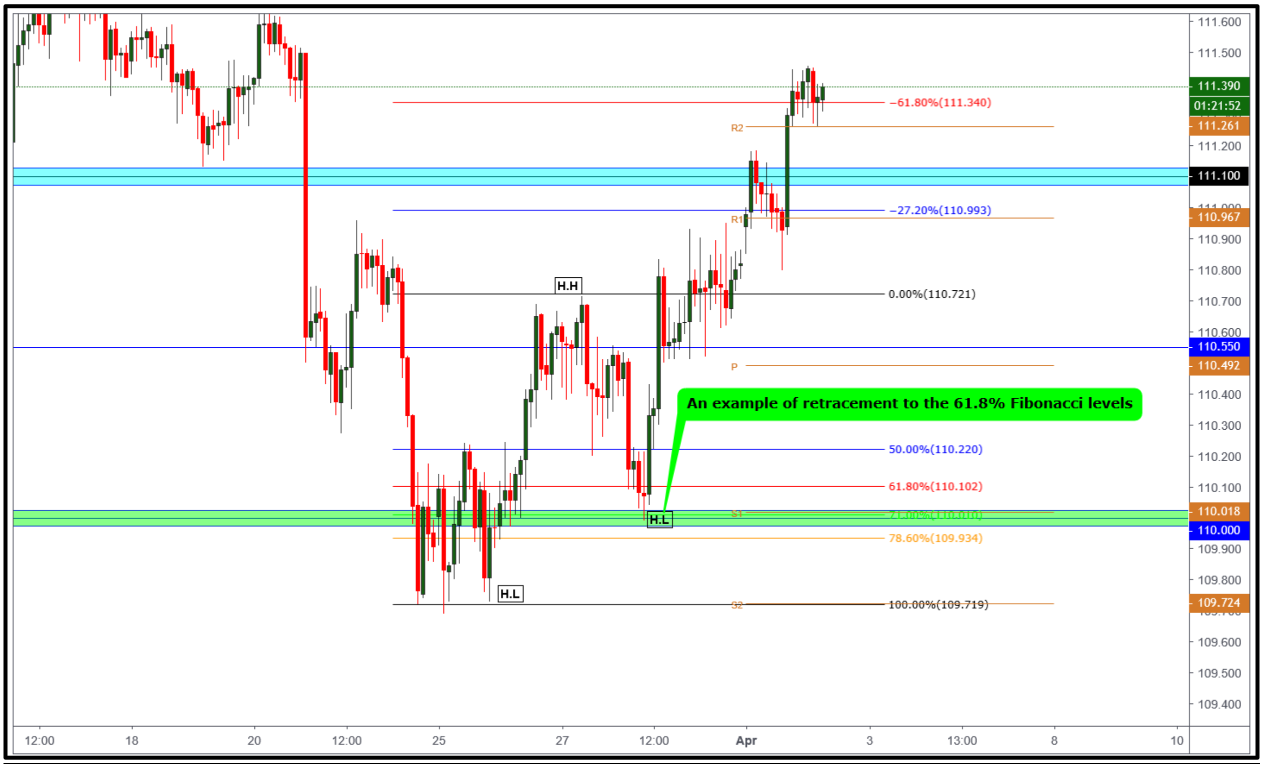
In the forex market we will use Fibonacci in 2 ways:

1. **To get entry triggers.(Fibonacci Retracements)**
2. **Set targets to get out in the markets while in profit.(Fibonacci Extensions)**

We will first look at how to plot Fibonacci and then look at each concept individually then combine the two of them to get a perfect relationship to be used by understanding how to use the combined concepts**.**

<u>**HOW TO DRAW RETRACEMENTS CORRECTLY AND ACCURATELY:**</u>

1. **You should draw Fibonacci levels from prior swing highs and swing lows.**
2. **Draw them on points which people can view, so that they become a self- fulfilling prophecy and can be used by other traders to make it an area of interest and increase the probability of the setup fulfilling.**



Traders should also note down the following key points when drawing Fibonacci levels:

1. Use of wicks is advisable on plotting this levels, this is because wicks show the highs and lows which are key when using this concept.
2. They are reliable swings while using the long time frames e.g. 1HR and 4HR Charts which show the opening and closing of candlesticks.

FIBONACCI RETRACEMENTS

A retracement can be defined as counter trend reaction that retraces a trend.

Also it can be referred to as percentage of values which can be used to predict length of corrections in a trending market.

The markets move in a wave like motion due to aspects like profit taking and some areas of supply and demand in the market.

We therefore use Fibonacci to get this levels so as to be able to get profitable set ups in order for you to get in and out of the markets.

The following is an example of the same scenario but on a daily chart:

From the following example one can deduce that the market bounced of the **golden fib region** which was also in confluence with **the trend line bounce** and rolled over to the **extension level.** Clearly this would be a good execution point for your trade in the financial markets.

FIBONACCI EXTENSIONS

Fibonacci extensions can be defined as an impulsive action that continues a trend after a retracement.

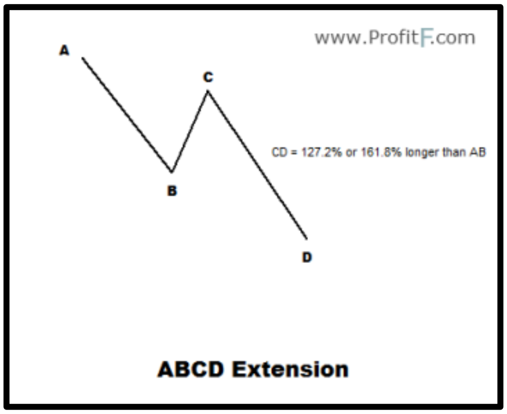
There are 2 main ones 1.272 and 1.618 extensions.

Good **for finding targets** in trends especially if they are in confluence with **key levels** as trends are likely to terminate at this levels if not permanently, temporarily due to profit taking.

Examples shown**: The following is an example of a move showing the Fibonacci extensions especially the 127.2%**

The markets moved directly to our extension targets after bouncing of the 61.8% retracement level.

Extensions are mainly used together with retracements which results in the formation of the **(A. B. C. D)** pattern:



Traders are emotionally attached to the key levels and extension levels which are used by many traders to set take profit targets in the markets.

SUMMARY

We have introduced you to the concept of Fibonacci ratios, sharing with you the two methods that we use to break down markets and come up with high probability trades.

It is now your task as a newbie to practice plotting this levels watching how the market has reacted to this levels, back testing will be a great strategy in helping you familiar with this concepts.

We should also warn that we have not shared several techniques that we used combined with this tool to generate ideas, for those fortunate to purchase our other course packages you will be lucky to get this methods in trading the financial markets.

You can also watch our YouTube channel for further breakdown of the charts and an introduction to this concept:
https://www.youtube.com/channel/UCGZ595tFkjl4UOH3S9_GQ7Q/videos

PIVOT POINTS

What Are Pivot Points?

If you are a novice in trading then this can be a new tool to you but if you have been trading or have been involved in the financial markets then you must have come across the term **pivot points.**

This will be a brief but detailed introduction into this analytical tool used by many traders to try and form an edge which they can profit from.

A pivot point is the price at which the direction of price movement changes. It is calculated using data from the previous trading session.

Here at Financial Hub we don’t consider it to be an indicator but a technical tool.

Traders are always on a mission to find the next level of **support and resistance** on the asset they are trading. Back in the floor trading days, professional traders developed this tool to help them identify future zones of supply and demand using previous session’s data.

Pivot point analysis is often used in **conjunction with calculating support and resistance levels, similar to a trend line analysis**. In a pivot point analysis, the first support and resistance levels are calculated by using the width of the trading range between the **pivot point and either the high or low prices** of the previous day. The second support and resistance levels are calculated using the full width between the high and low prices of the previous day.

Pivot points are commonly used as intra-day indicators for trading **currencies, stocks, futures, commodities and bonds.**

Unlike moving averages or oscillators, they are static and remain at the same prices throughout the day, week or month depending on the timeframe you are watching.

Data from the prior session's trading range is used as an input to generate five pivot point levels.

The pivot point levels are composed of a pivot point, three higher resistance levels known as **R1, R2 and R3, and three lower support levels S1, S2 and S3.**

<u>Here is the formula:</u>

Resistance 3 = High + 2*(Pivot - Low)

Resistance 2 = Pivot + (R1 - S1)

Resistance 1 = 2 * Pivot – Low

Pivot Point = (High + Close + Low)/3

Support 1 = 2 * Pivot - High

Support 2 = Pivot - (R1 - S1)

Support 3 = Low - 2*(High - Pivot)

Pivots are used by most traders to **find entries, take profit zone and stop loss levels.** Traders will watch for the market to reach these levels for them to make a sound trading decision.

Suppose the price is below the pivot at the open and you decide to go short at that point. The first price you will look at to cover is the first support level.

Of course, you would rather hold onto the short position if there were an indication that prices will fall further but **S1** will be the first point of hindrance for the downside. **S2** will be your **second level** to watch if traders continue to **lower the prices.**

The converse applies to an uptrend. If prices were above the pivot, you would enter a long position and use the first and second resistance levels as your profit objectives.

Pivot points will be calculated automatically for you in the markets; it is therefore your task as a student to observe how price action behaves on the various support and resistance levels.

How Pivots Look On a Chart:

On the Chart Above you can see how the Pivot Levels are plotted.

Learning to profit from this tool will be discussed deeply in **our PRO package** and with that one can apply this tool into his or her daily analysis.

SUMMARY

Using this technical tool is easy and simple to understand, however traders must understand that use of this tool is highly intuitive. Traders should therefore learn the value of patience while still familiarizing themselves with this tool.

MOVING AVERAGES

A moving average is a technique to get an overall idea of the trends in a data set; it is an average of any subset of numbers.

The moving average is extremely useful for forecasting long-term trends in sales, prices, yields, population etc.

You can calculate it for any period of time. For example, if you have sales data for a twenty-year period, you can calculate a five-year moving average, a four-year moving average, a three-year moving average and so on.

Financial Market analysts will often use a 50 or 200 day moving average to help them see trends in the financial market and (hopefully) forecast where the prices are headed.

Financial Markets are choppy and erratic in nature; the chart of a certain asset is not as smooth so as to clearly gauge the dominant direction. Traders then came up with this tool to help them smoothen out the choppy price action into a clear line that can show the sense of direction.

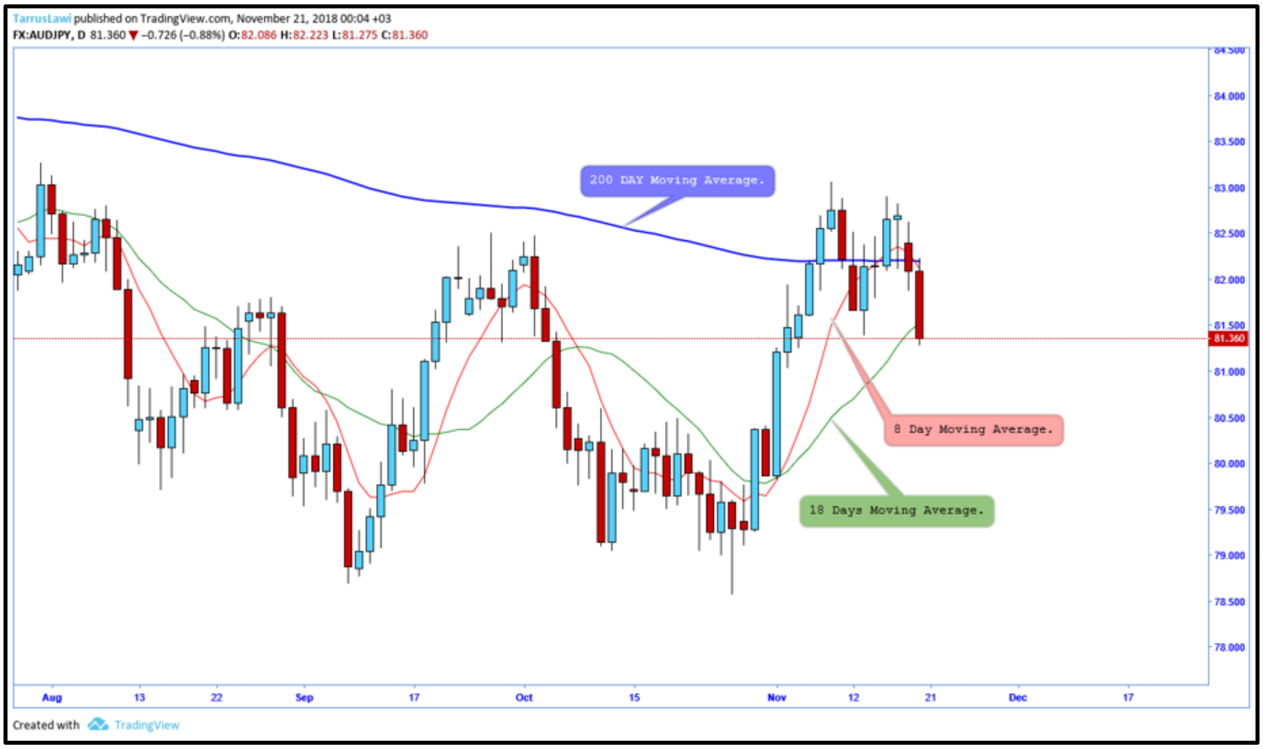
We have three main type of moving averages.

- **Simple Moving Average**
- **Exponential Moving Average**
- **Weighted Moving Average**

The difference is in how they are calculated and averaged. We will not go down to show you the details of how they are calculated since the markets will always do the calculations for you. Any trader who wants to know how to calculate can however do a Google search and that will enable the trader to understand how to calculate the formation of this tool.

We will only give you the three ways which we use this technical tool in the following section:

How Moving Averages look on a chart:



USES OF MOVING AVERAGES

Moving Averages serve the main purpose of smoothening out price from the choppy nature of the market.

With that it helps a lot of traders past just smoothening the price, moving averages have been used to:

1. **Confirm the trend.**
2. **Show momentum.**
3. **Find dynamic areas of support and resistance.**
4. **Identify take profits and stop loss levels.**

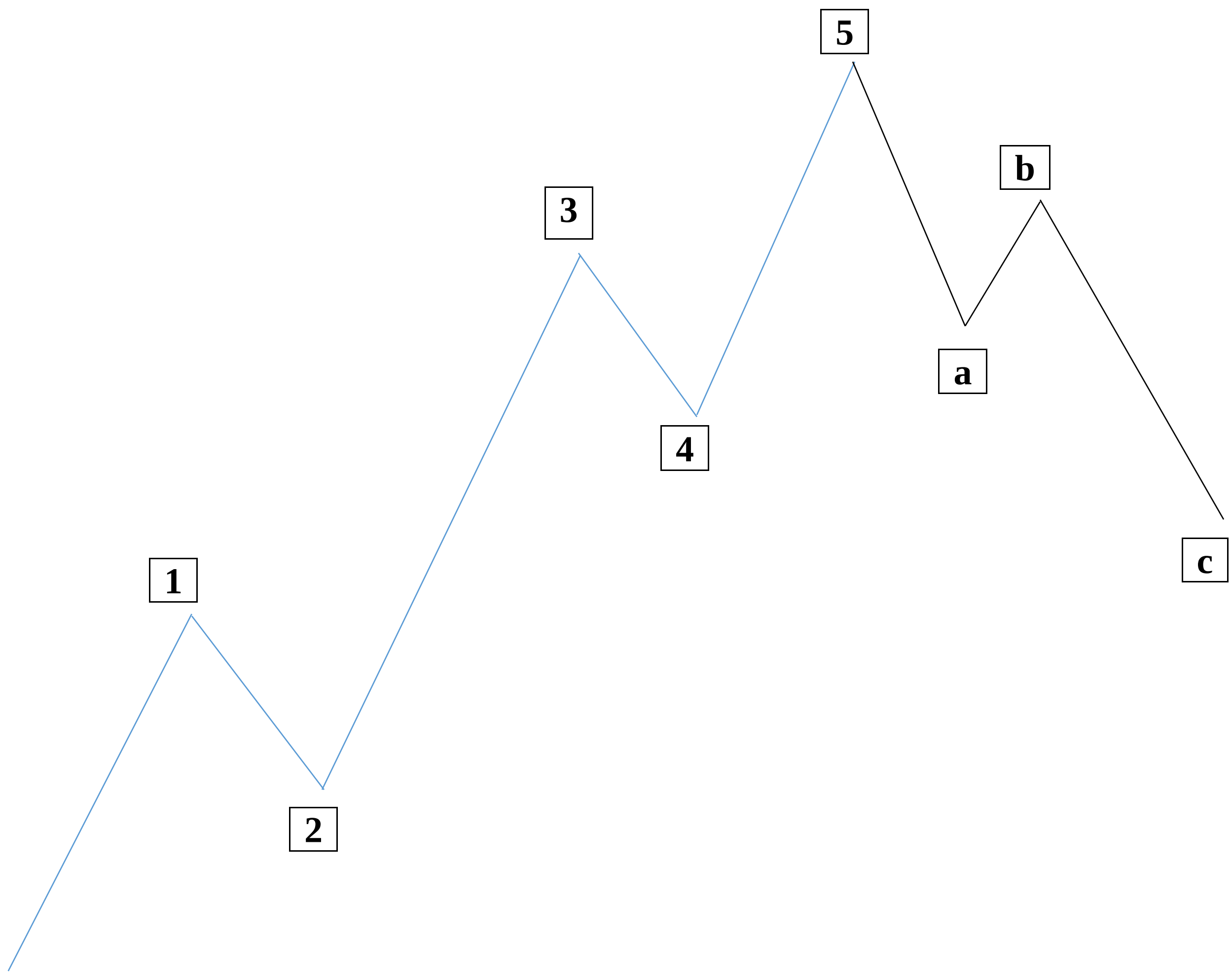
<u>ELLIOT WAVE THEORY</u>

Ralph Nelson Elliot discovered that the markets thought to behave in a chaotic manner, actually didn't. According to him, the markets traded in repetitive cycles, which he pointed out were the emotions of investors caused by outside influences or the predominant psychology of the masses at the time.

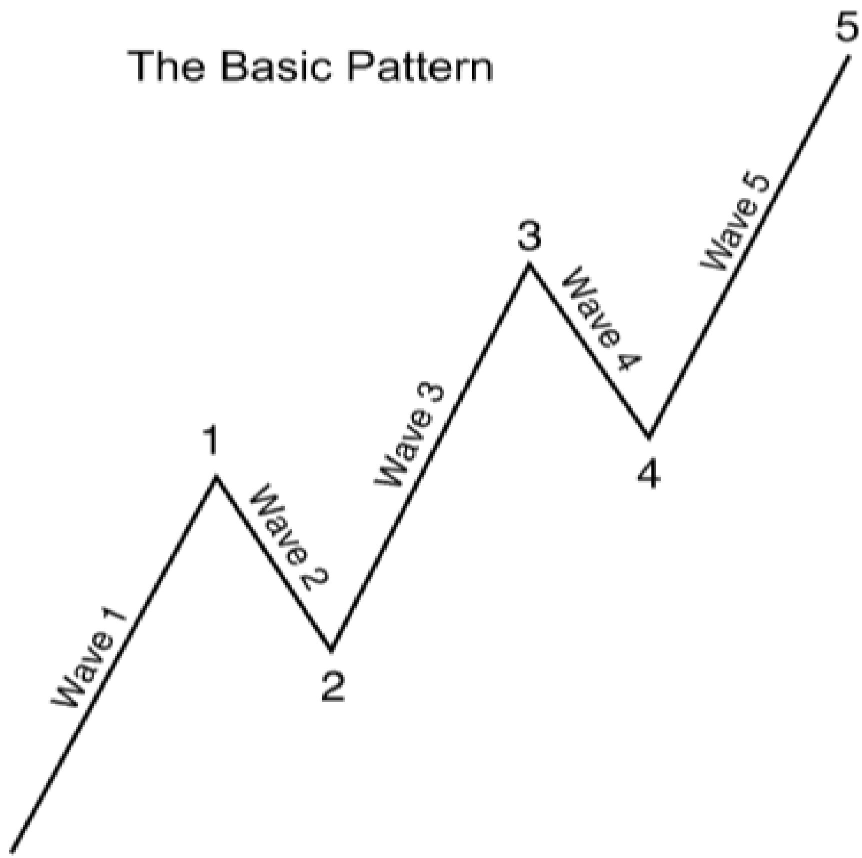
Elliot explained that the upward and downward swings in price caused by the collective psychology always showed in the same repetitive patterns. He called these upward and downward swings 'waves'.

Elliot waves are used to give traders precise points to identify where price is most likely going to reverse.

Elliot waves are made up of **Motive waves** and **Corrective Waves.** Motive waves have a **5 wave structure (1-2-3-4-5)** while corrective waves have a **3 wave structure (a-b-c)** as shown below.



MOTIVE WAVES



Motive waves are subdivided into 5 waves and always move in the direction as the trend of one larger degree. Three of these waves, which are labelled 1, 3 and 5, are generally known as Impulse waves, actually effect the directional movement. They are separated by two countertrend interruptions, which are labelled 2 and 4.

WAVE 1

The currency makes its initial move upwards. This is usually caused by a relatively small number of people that all of a sudden feel that the price of a stock is cheap so it's a perfect time to buy. This causes price to rise.

WAVE 2

At this point, enough people who were in the original wave consider the price overvalued and take profits. This causes the stock to go down. However, the stock will not make it to its previous lows before the stock is considered a bargain again.

WAVE 3

This is usually the longest and strongest wave. The price has caught the attention of the mass public. More people find out about the pair and want to buy it. This causes the price to go higher and higher. This wave usually exceeds the high created at the end of wave 1.

WAVE 4

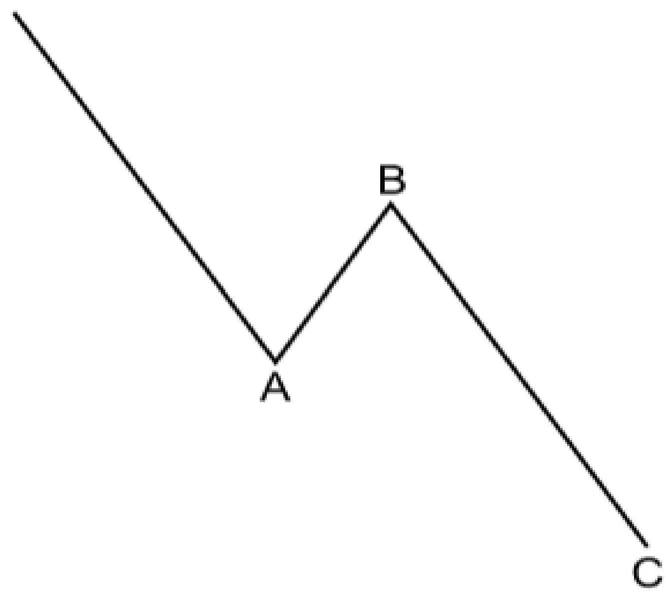
Traders take profits because the pair is considered expensive again. This wave tends to be weak because there are usually more people that are still bullish on the stock and are waiting to buy on the dips.

WAVE 5

This is the point that most people get on the market and is most driven by hysteria, an example is the stock market. Traders and investors start coming up with ridiculous reasons to buy the stock and try to choke you when you disagree with them. This is when the price becomes the most overpriced. Contrarians start shorting the stock which starts the Corrective Wave (ABC).

CORRECTIVE WAVE

The 5 wave trends are then corrected and reversed by 3 wave counter trends. Letters are used instead of numbers to track the correction.

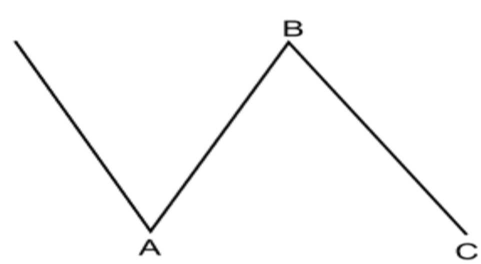


Corrective waves are divided into 3 main types:

1. **Zigzag**
2. **Flats**
3. **Triangles**

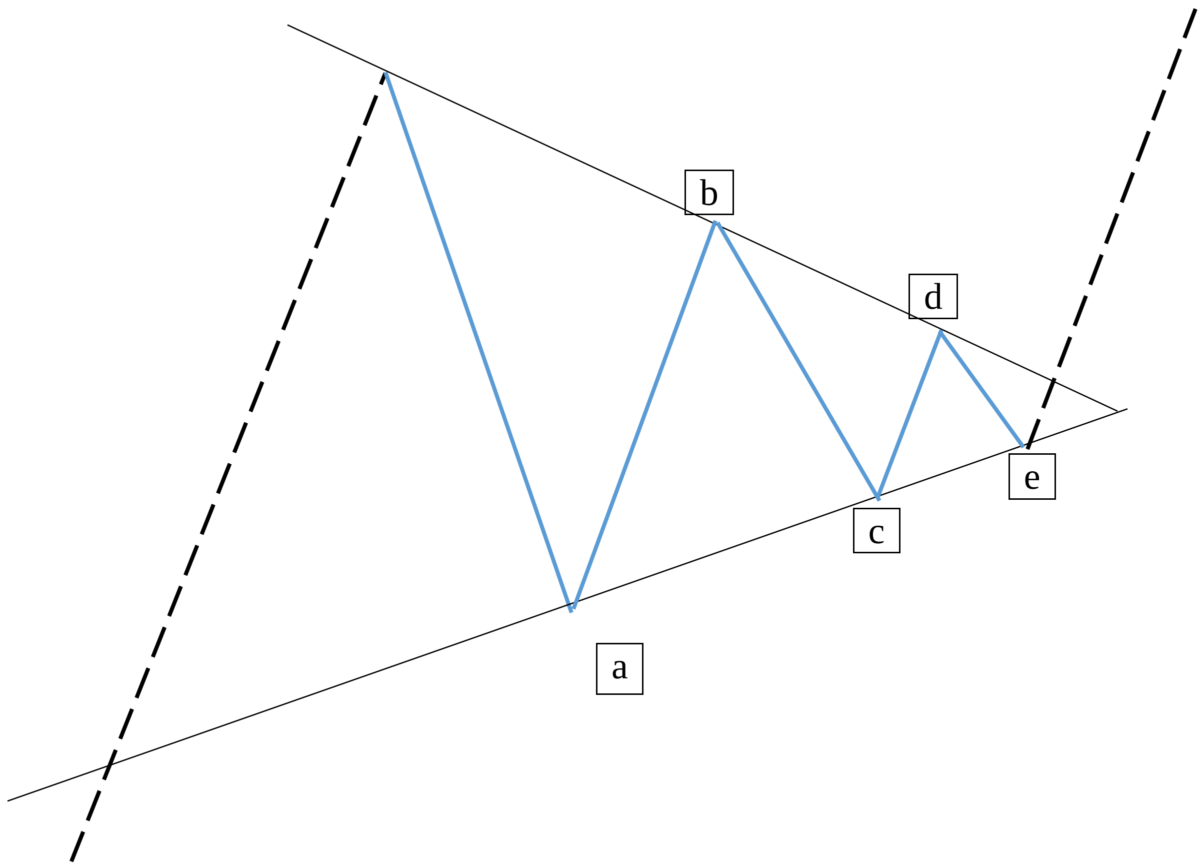
The above image is a simple example of a **zigzag** ‘a.b.c’ wave.

A **Flat** is quite different from the zigzag formation and looks like the image below:



It is usually called a flat because of the same distance that all the waves cover. Wave A begins the correction after the market peaked at wave 5. As wave B begins, it reaches the same level where the market had peaked and then drops forming wave c which finds support at the same level wave A did.

The **Triangle** forms in sort of a symmetrical way, just like we covered in Chart Patterns. What is of importance when it comes to the Elliot Triangle is that is made up of 5 points:



RULES TO FOLLOW WHILE TRADING THE ELLIOT WAVES

1. Wave 3 can NEVER be the shortest impulse wave
2. Wave 2 can NEVER go beyond the start of wave 1
3. Wave 4 can NEVER cross on the same price area as wave 1
4. Wave 3 tends to be very long, sharp and extended
5. Waves 2 and 4 often bounce off Fibonacci Retracement levels

CHART PATTERNS

In the Top down Analysis, apart from the **Trend lines, Key Levels and Price Actions** that we have already covered, Chart Patterns are as important to add to your analysis as they give a clearer picture of what exactly is happening in a trend or while the market is in a consolidation.
They are formed as a result of people's behavior in the market and a repeat of history in the markets. These two aspects contribute greatly to the aspect of chart patterns.
We will go through several chart pattern formations showing and explaining why they are formed and how the markets play out after hitting these levels.

The trader will be able to understand the following concepts as you read through:

1. **Chart patterns and market sentiment.**
2. **Trade execution based on chart patterns.**

HEAD & SHOULDER

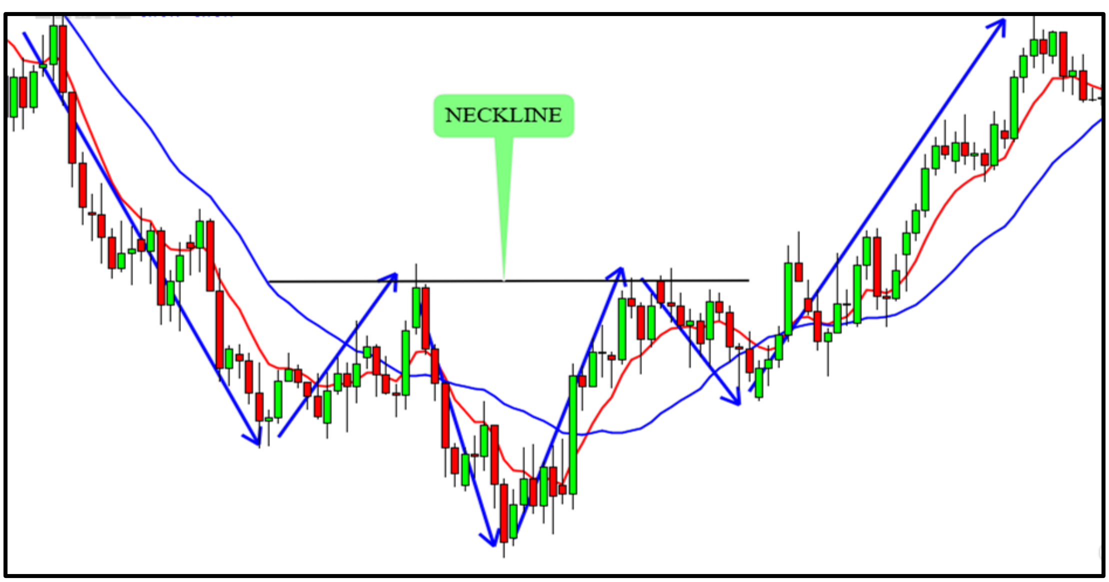
The head and shoulder also a good trade pattern to rely on in order to catch some crazy PIPs.
They are mainly Reversal Patterns and form after an uptrend. They also form after a downtrend but in this case they are called **Inverse Head and Shoulder**, but basically have the exact same characteristics as those that form after an uptrend.
The **Head and Shoulder** pattern basically has **two shoulders and one head**, just like the human body.
The left shoulder, which begins the pattern, forms after a **series of higher highs and higher lows.** The market reaches a **significant high, left shoulder (resistant level), and then retraces back down, forming a higher low (neck line) and then continues to a higher high (Head) where it loses momentum and reverses back down.**
Upon changing the trend direction, the market is pushed to the previous low (neck line) which acts as a support, then rallies back up to a resistance level in line with the left shoulder.
At this point, the right shoulder is formed. This in turn paves way for the market to go to lower lows, finishing the last leg of the pattern.

A sell trade can then be executed upon break of the neckline confirming a downtrend in play.

INVERSE HEAD AND SHOULDER

The **Inverse Head and Shoulder** is the exact same as the Head and Shoulder but forms after a significant downtrend, reversing the trend back to an uptrend, applying the same principles but opposite.

Note: The **neckline** is the line that acts as support or resistance before and after the formation of the head. Better seen if a support line, resistance line or trend line is drawn to join them.

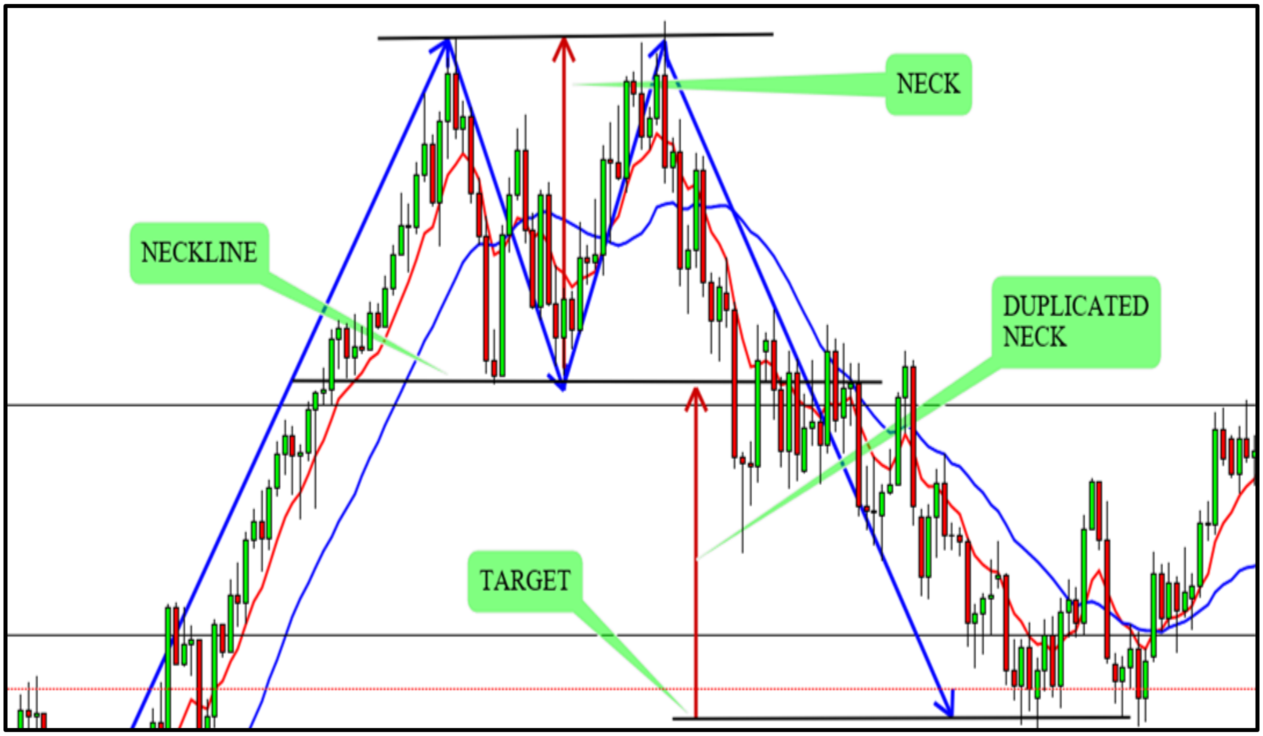


The distance between the Head and neckline is known as the **Neck**. It is best if drawn with an arrow as shown below and then duplicating the arrow and plotting it above or below the neckline.
This distance is important in this formation as it helps one know how far up or down the market might move after bouncing off the right shoulder and where to set target profits.

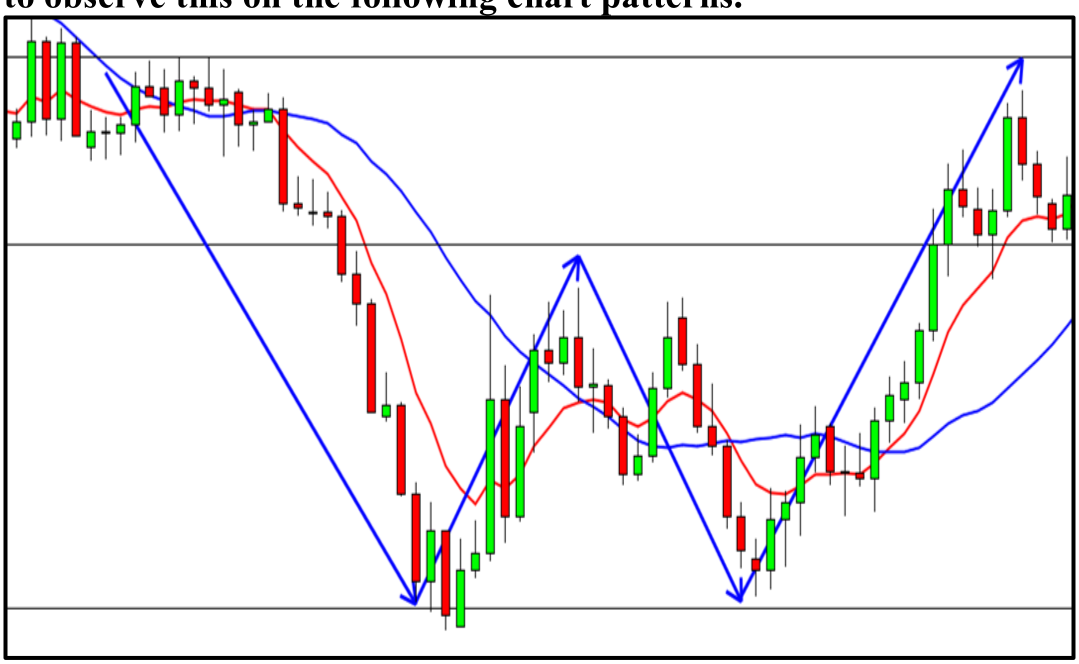
Head and Shoulder Pattern can be used in line with other indicators especially the Fibonacci Tool to confirm resistance and support levels (turning points).

DOUBLE TOP & BOTTOM

This common pattern is one that is often formed on both a trending market and ranging markets. **They basically form when the market retests a point of previous high or low**.
Just as the name suggests, **Double Top forms as the market retests the previous high during an uptrend and then moves downwards, forming 'M' shape. The Double Bottom forms as the market retests the previous low in a downtrend before going back up, forming a 'W' shape.**



Just like the Head and Shoulder, the double top and bottom too have a neckline.
Using the Double Top as an example; the market reaches the top of the trend to a resistance point, which acts as a rejection zone. It has a short pull back to a point of significant support. At this point, a neckline/base is established and the markets heads to retest the resistance point again.
In the case of a double bottom, the reverse would happen and we can be able to observe this on the following chart patterns.



The **neck** formed in the process (distance between the top and neckline) is then used to determine how far the market will reach, by drawing an arrow between this two points and duplicating it below the neckline.
This lower point can be used as a target profit area as the market can bounce back up, consolidate or head further down after reaching this point.

We personally like this pattern because of two important reasons:

- It greatly confirms that the market has tried to break a resistance or support level twice and both times got rejected, pushing the market in the opposite direction, confirming the new trend direction.

- One can have a stop entry at two levels. If a person is an aggressive trader, he or she can execute a trade after a close of the candle stick which retested the resistance or support, depending on how the candlestick closes.

- Or if you're a conservative trader, it is best if you wait for the market to close above or below the neckline, confirming the market has changed direction as it forms a higher high or lower low. Now imagine if you executed a trade at both levels, your PIP count would explode just from this chart pattern.

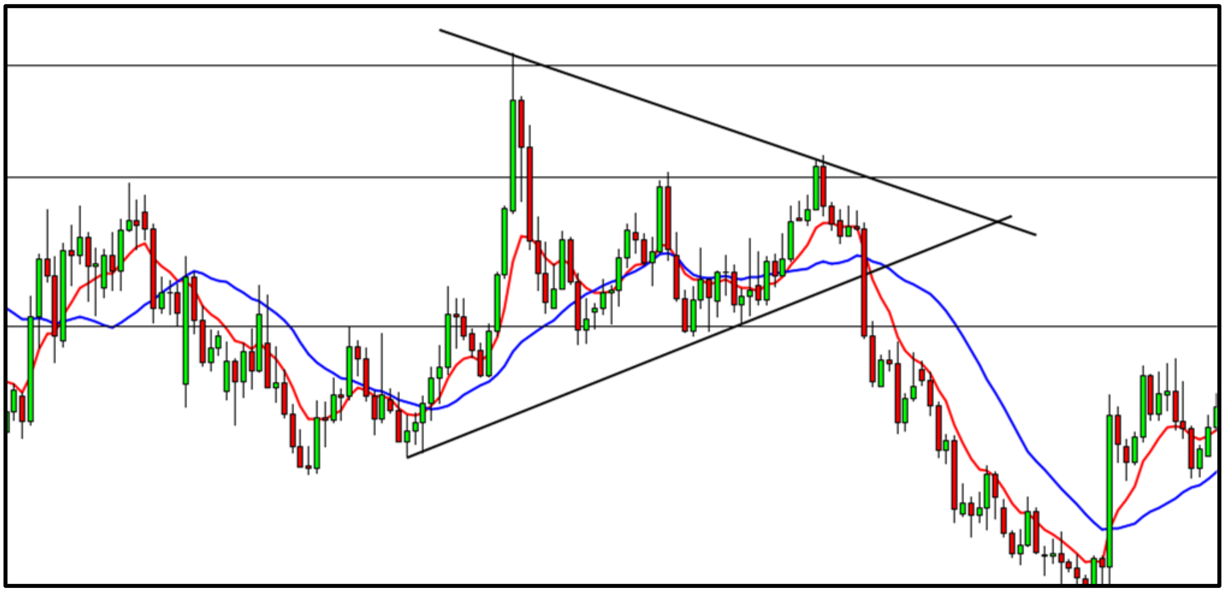
TRIANGLES

Triangles are very common trading patterns that can easily be spotted on multiple charts.
Triangles are a form of consolidation pattern that anticipates a break on either side depending on what kind of triangle was formed.
There are various types of triangles; we will however go through the symmetric triangle:

- **Symmetric Triangle**
- **Ascending Triangle**
- **Descending Triangle**

SYMMETRIC TRIANGLE

These are triangles that are formed after a series of lower highs and higher lows. If trend lines are drawn to connect the two, they converge at a point to form a symmetric triangle as shown below.



Just as we said in the beginning of this topic, triangles are a form of consolidation pattern, and therefore we should anticipate a breakout at either side.
The formation of the lower highs and higher lows shows that there is indecision in the market, and no clear sense of direction. This is the reason one should anticipate a break on either side.
It is also important to measure the length of the opening of the triangle, known as **base**, with an arrow, and then duplicated to either side of the triangle, as this gives an estimation of how far the market will reach after the breakout.

WEDGES

Wedges signal a pause (consolidation) in the current trend. At this point, traders are still deciding where to take the pair next, and therefore wedges can serve as either continuation or reversal patterns.

Wedges have almost the same characteristics as the Triangles.

There are two types of Wedges:

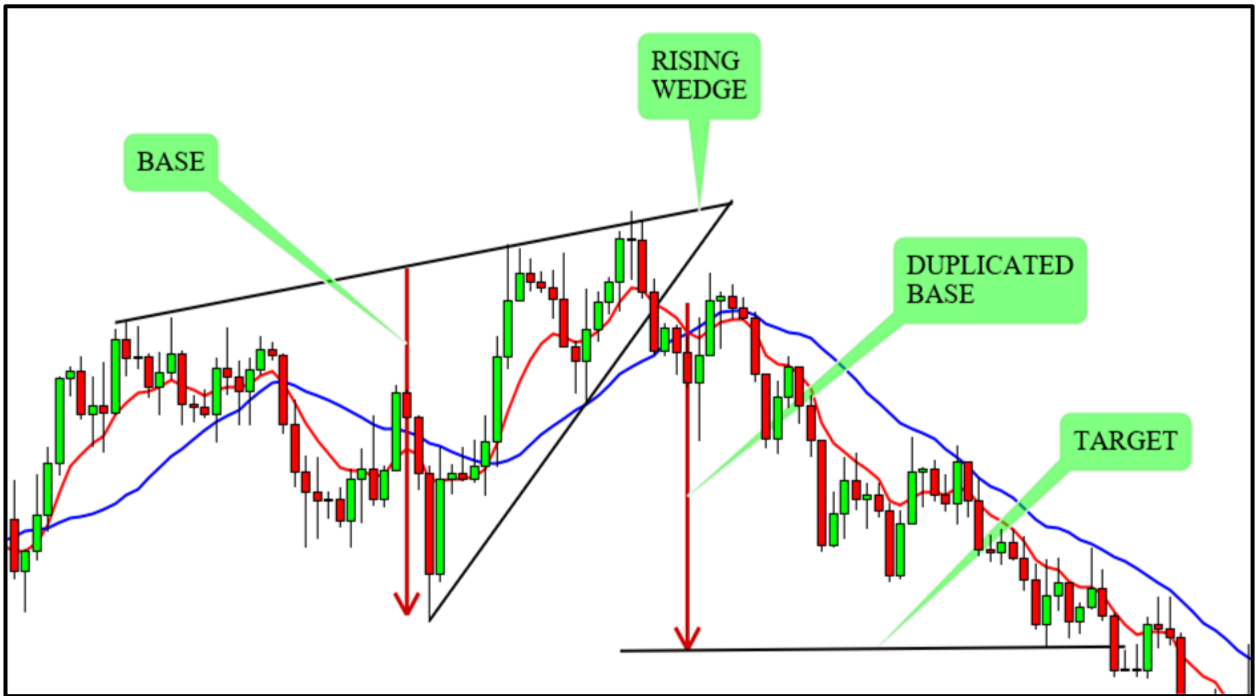
- **Rising Wedge**
- **Falling Wedge**

RISING WEDGE

A rising wedge is formed with higher highs and higher lows, and they act as a **bearish signal**.

If a trend line is drawn to join the higher highs and another to join the higher lows, you will notice the slope of the support is steeper than that of the resistance. This indicates that the Bulls are slowly losing control and can’t take the market to significant higher levels, and therefore the bears take advantage and pull it back down.

If the rising wedge is formed after an uptrend, you should anticipate a bearish reversal. If it is formed after a downward trend, then in means a continuation to the down side is imminent.



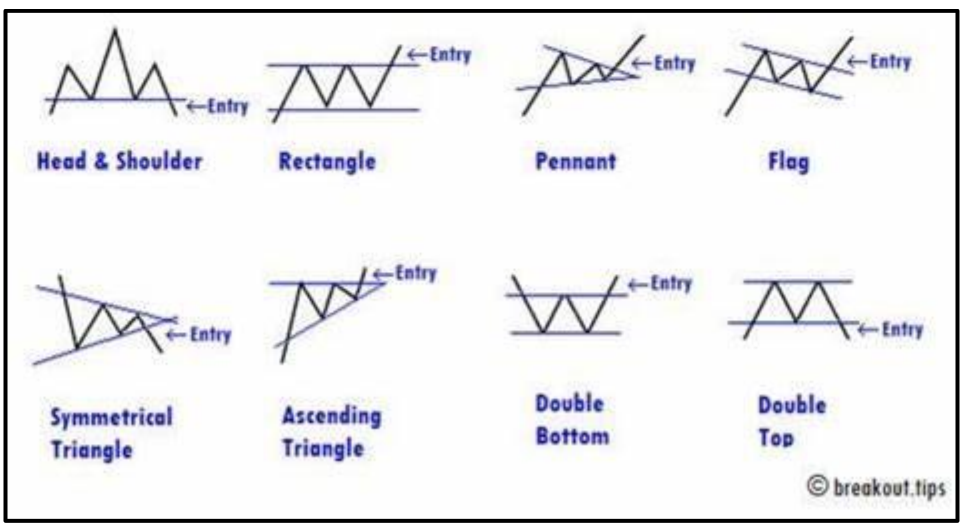
FALLING WEDGE

A falling wedge is formed with a series of lower lows and lower highs, and they act as a **bullish signal**.
If a trend line is drawn to join the lower lows and another to join the lower highs, you will notice the slope of the resistance is steeper than that of the support. This indicates that the Bears are slowly losing control and can't take the market to significant lower levels, and therefore the bulls take advantage and rally it back up.
If the falling wedge is formed after a downtrend, you should anticipate a bullish reversal. If it is formed after an uptrend trend, then in means a continuation to the upside is imminent.

SUMMARY

We have gone through various chart patterns but not all; it is your task as a student to make sure you dive deeper into understanding this topic. Traders should also spend a great amount of time on their charts trying to identify and plot chart patterns.

We will therefore show you a photo illustrating the various chart patterns:



TECHNICAL INDICATORS

Technical indicators can be defined as tools that use a series of data points and various mathematical formulas to define a perspective on market behavior.

Just like any other tool, technical indicators are used by traders as a means of knowing where the markets are headed and to confirm certain biases in the financial markets.

There are several technical indicators that can be used to trade markets; we will however categorize them into 2 major categories: **Leading Indicators and Lagging Indicators.**

Leading indicators give us an indication or price signal just before an actual price level is hit; they simply inform us before price action has behaved in a certain way. Most leading indicators will tend to measure the momentum or the degree of the slope of current price movement.

They Include: **Relative Strength Index (RSI), Stochastic Oscillator, Commodity Channel Index (CCI) and Pivot Points.**

Lagging indicators on the other hand give us an indication or price signal after a new trend has started. Unlike the leading indicators, Lagging Indicators will inform us based on the behavior of price action.

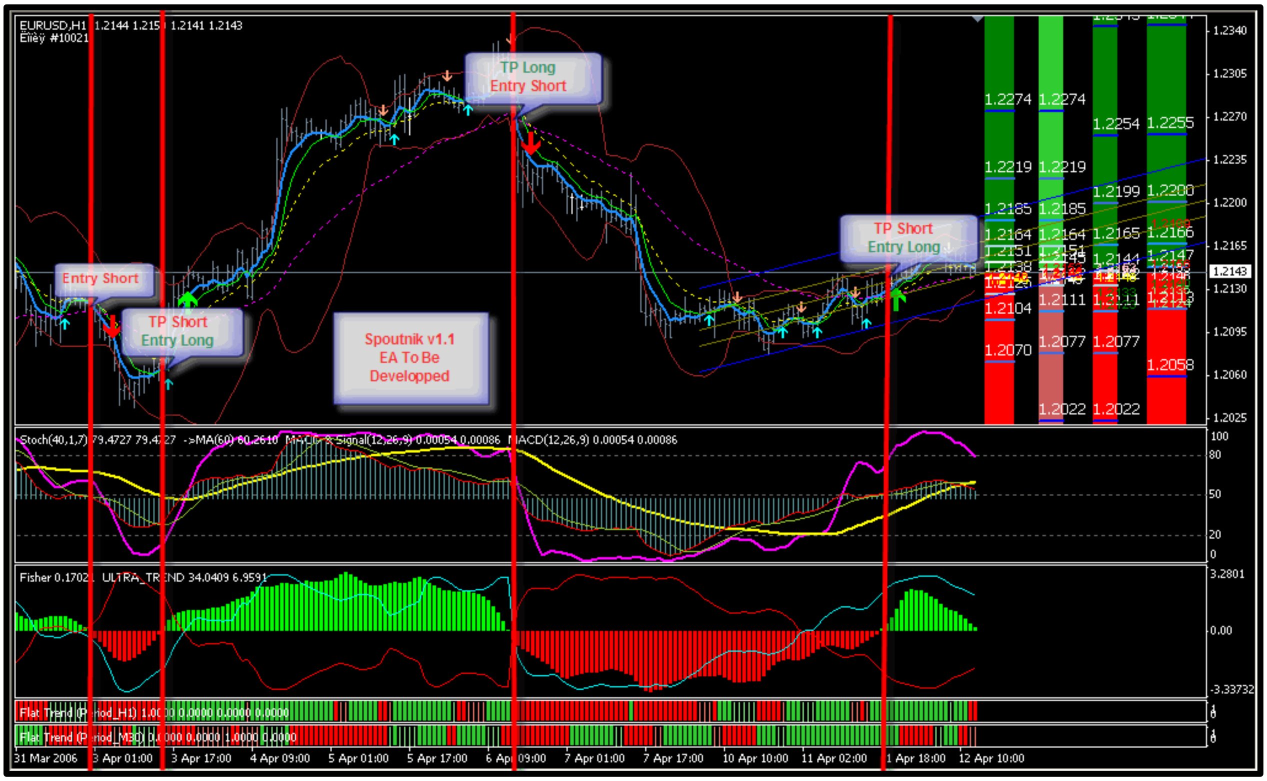
They Include: **Moving averages, Bollinger Bands and Moving average convergence divergence (MACD).**

We will not go into detail to describe the use of each and every tool and we will instead leave that research to be done by the reader.

We will however warn that using all of this in your trading will make trading complex while success in trading is about simplicity. This is because most of these indicators are used for the same purpose which is identifying trade setups and capitalizing on them which can be done in a simpler and more accurate manner.

Newbies often make the mistake of making their charts full of indicators with the hope of making trading easier and instead they end up confused not knowing when to buy and sell.

The following is a chart example full of indicators and tools in the markets:



We would recommend sticking to at most one or two indicators and perfecting how to use the two rather than trying to use all with mastery at none of this tools.

The following is an example of a neat chart with analysis from pro trader:

You will clearly observe how easy it is for the pro trader to make decisions in the market unlike the Beginner who believes that more is better, in this game the only mantra you can live by and succeed is **"less is better"**.

<u>SUMMARY OF TECHNICAL ANALYSIS</u>

Technical analysis is broad; we can't use all the resources available to us. This is because we will end up confused with our decision making limited since we have many tools to look at. In the markets, making decisions fast is a skill that must be mastered by traders.

We should therefore learn to follow the principle **less is more**. By mastering three or four tools and combining them together one can be able to come up with a high probability edge which can enable you to make money trading.

It is an exercise in futility trying to get a system that will work all the time that system does not exist. In an environment where randomness is the rule then it is extremely hard to get something that works all the time. We have not shown you how we combine these tools and come with high probability setups. One can however watch our market breakdowns on YouTube and you can get a rough idea on how to go about the markets. The link is below:
https://www.youtube.com/channel/UCGZ595tFkjl4UOH3S9_GQ7Q/videos

BEGINNERS GUIDE TO FUNDAMENTAL ANALYSIS

As a new trader you'll often see price movements on the charts be it in candlestick form, line graph or whichever layout you prefer but most probably you might not know the reason to such movements.
Fundamental is the answer, fundamental analysis focuses on the **'Why'** of price **valuation** of different financial instruments; **stocks, indexes or currencies.**
Fundamental analysis affects the market in both long and short term durations and they assist investors/traders in making investment decisions.
Historically fundamentals were used to evaluate company worth by stock price valuation but the model was passed on as new markets emerged to assist in doing the same.
The two main purpose of fundamental analysis in the financial markets are:

1. **Determining the short-term impact on currency pairs.**
2. **Forecasting long-term trends.**

We'll take a brief look on the four important factors in the pricing process for financial markets:

- **Current business conditions**
- **Interest rates**
- **Inflation**
- **Spending Habits**

BUSINESS CONDITIONS/CLIMATE

Businesses and currencies share the same factors that affect their values. But in the financial world governments tend to focus more on the economic conditions to help them determine what fiscal policies to set.
Governments watch the overall economic conditions periodically through various departments to make sure the economic health is at balance, for example if an economy is doing well through more production than consumption more money gets to be borrowed in order to expand.
This triggers governments to raise borrowing rates to maintain inflation levels at a healthy standard but attract more investors at the same time due to a strong currency.
When business conditions deteriorate, rates get lowered making investors flee to other countries with better business conditions and currencies that yield high cause low interest rates have negative impacts on business returns i.e. **high interest rates mean a stronger currency and lower interest rates mean a weaker currency.**

INTEREST RATES

Just as we have explained in the previous section interest rates play a key role when it comes to making investments decisions. One way through which investors take advantage of interest rates differential is by buying a currency with higher interest rates, collecting that interest and then selling a currency with a lower interest rate; **carry trade.**

The Business cycle also plays a big role in the movement of interest rates; one can therefore learn how interest rates move up and down by understanding the business cycle.

INFLATION AND COMMODITIES

Inflation has different meanings depending on who you ask but the most common simple definition known by many is simply upward spiral in price. When inflation picks up many intelligent people or investors buy commodity products in bulk to hedge themselves against future high prices, fear being the main influence instead of good business conditions.

Governments on the other hand try to counter the move by raising cash deposit rates so as to lure individuals to sell off their stock piles in exchange for cash which can earn from high interest rates, a trick that doesn't work for everyone. Some weigh returns of both opportunities and hang on to their commodity stocks, to cut the long story short; a rise in commodity causes a rise in value of the currency of a country that holds large supplies of the commodity but it's wise to keep in mind that currency valuations are relative and commodities should be traded individually on the basis of price movements.

CONSUMER HABITS

Individual and government spending also have significant impacts on the economy. We know the question running in your mind right now is **"How does my spending nature affect the economy?"** Human nature of interdependence often leads us to share different traits and characteristics, not all but some of us. Generations(X,Y,Z) is a good example of how we humans share traits; kids are known to be playful, teenagers known to be curious about life and contain both traits of adults and kids, and adults known to develop a sense of responsibility.

The main purpose of the above example/explanation is to show you how one generation or age group can have a significant effect to the economy if an epidemic habit is formed among them. Take an example of selfie-sticks, social media or technology in general, when the technology boomed Generation Y (millennial) became the major consumers leading to significant growth in tech companies. Back to the main point, excessive spending without income flow to fill in the gap created leads to debt accumulation in order for people, businesses and governments to survive. Debt is mostly considered a harmful thing but it's also a useful tool especially when used to generate income with guaranteed payment but when payment isn't guaranteed individual and government economic positions decline. Governments come to the rescue by lowering interest rates to ease spending which fuels consumer spending, lending to and buying into industries and companies.

Now we'll dive into some of the key economic reports but we won't focus on all currency reports but the U.S. fundamentals because the dollar is the most involved currency in world transactions, approximately 70% of all currency transactions. The same interpretations we make on the U.S. economic indicators apply the same way to other countries' fundamentals in relation to their country valuations.

SUMMARY

We have not covered any concept under this topic broadly; this is because we don't use fundamental analysis a lot compared to technical analysis. We use the 80/20 rule when it comes to fundamental analysis. This means we only rely on fundamentals 20% of the time.

This is because at the retail level, getting Data is hard and again one gets data pretty late. This makes this method a disadvantage for the swing trader.

However in determining the long term trend or direction of a pair or asset, fundamentals can be more instrumental than technical. Understanding this field is therefore still important since one has to switch roles in the markets at times.

We will now move to the next topic which is psychology of forex trading.

BEGINNERS GUIDE TO PSYCHOLOGY OF FOREX TRADING

"Know the Enemy and Know thyself and in a hundred battles you will never be in peril"

Success or failure is a choice, those who succeed and those who fail have totally different traits and thinking patterns.

Our minds and thinking as humans is the greatest advantage we have over all other creatures, it is unfortunate some of us don't tap into our full potential in our lives and in many activities we do such as trading.

Trading psychology will contribute greatly to your success or failure as a trader. It is evident that anyone can understand technical analysis or fundamental analysis when taught, but no one can teach you how to develop a feel for the markets. The psychology of trading will play a big role in taking you down the path to understand markets clearly and get in sync so as to make money.

When it narrows down to trading psychology there are so many things that you will learn that are not only useful in trading but also in general life and business.

Trading is directly opposite to human nature, you have to be willing to deal with the emotional roller coaster and stressful times for you to reap the rewards that follow when you become a successful trader.

The psychology of trading involves the study of a trader's behavior and mind with an intention of building the best habits and developing a trader's mindset. Good trading habits is what will make the best traders, this is because in the long run what matters is not a single trade but the multiple trades that you execute in the forex market.

Successful trading will demand that the trader get to narrow down to understanding how the mind works and specifically pay attention to his own mind, a deep understanding of the two will unveil the road map that traders need to take so as to master the psychology of trading. Understanding how the mind is wired will help in getting to know and predict the behavior of the consensus in the markets that don't make money in the long run. A deep understanding of thyself will enable you to build the best habits and join the minority in the markets who will mainly be profitable in forex trading. We will outline some of the most important concepts under this field and expect that you guys will go deeper to understand this topic.

RANDOM NATURE OF MARKETS

One of my best trading psychologist and educator , who recently passed Mark Douglas in his two books The Disciplined trader and Trading in the Zone explains in a layman's language the psychology of trading like nobody else does, Giving the reality of the financial markets that many dodge and the role of emotions in the success of a trader.

He insists that the uncertainty of any trade or the random outcome of trades is the reason why it seems so difficult to determine when to close a trade, both in profit and loss. And that's the hardest skill to actually understand and profit from in trading.
As humans, we tend to have an innate desire to control things, situations, and emotions, so when the fierce desire meets the uncontrollable market we almost automatically get a cognitive dissonance and no harmony .And for sure when things unfold otherwise we feel wrong and frustrated**.**

- **Every trade has a random outcome.**

Before making any trading decision, even when analyzing the markets, a trader should be aware that each trade has a possibility of either being a loser or winner, despite the amount of confluence and technical tools used to make the decision. A trader must always think in probabilities and put on risk measures to curb the loss side to prevent extreme drawdowns and also get a reasonable reward target too. From my experience in the market, I can say the normal market is one that never existed. And as a trader we have already decided to live in an uncertain world.

Blind trading is one of the reason why traders lose money in the markets and fail to account for it even when journaling , it's not that the trader did not analyze the market neither did he do enough due diligence before executing the trade, NO! It's basically they didn't understand that the outcome of that trade was almost 100% unpredictable at the time of execution and instead of getting cautious a trader gets hopeful that his analysis will fulfill and ends up not adapting to the edge, even if it was a working profitable edge. Every trade you take is totally unconnected and independent of the last trade you took or the next one you will take.

For sure it can be difficult to understand how you could how you could make money in the markets if every trade has an essentially random outcome; this is because the fact is in conflict with the fact that traders do actually make money consistently over time which is possible.

The difficulty lies in the fact that you need to hold two different understandings of trading in your mind:

1. You can make money consistently over time if you trade execute your trading strategy consistently over time.

2. You cannot control the market and every trade has a random outcome of any other trade you take.

"It's the ability to believe in the unpredictability of the game at the micro level and simultaneously believe in the predictability of the game at the macro level that makes the casino and the professional gambler effective and successful at what they do."~ Mark Douglas.

CONSISTENCY IN A RANDOM MAKET.

"Millions come easily to a trader after he knows how to trade than hundreds did in the years of ignorance''- Jesse Livermore

The random walk theory states that the movement of prices in the markets are random and that we can't be able to predict where prices are headed based on the past behavior of price action. We partly agree and disagree with this statement; in the context of technical analysis we totally disagree with this theory but in the field of psychology we want to be believers of this statement. This only means that despite developing an edge in the markets it is extremely hard to tell which trade will be the winner and which one will lose money. The only option that we are left with then is to repeat some activities in the market with the condition that our system has a **positive expectancy**. We therefore can make money in the long run.

Consistency can be simply defined as doing an activity in the same way over time. The overall goal in trading is not to just get one winner trade but to get multiple trades right and wrong and still be able to make money. This can only be achieved by understanding consistency.

Simply meaning that you have to understand that at the level of one trade anything can happen but at the level thirty trades my methodology will make me money.

Consistency is achieved by understanding that every moment in the market is unique and getting your mind across the fact that not all trades you take will turn out well. You have to be disciplined and have general rules of thumb that can help you get to that level of consistency.

This does not happen overnight within a month or two it takes time constantly designing an edge that fits your personality and taking opportunities to observe what works and what doesn't work. Trading to achieve consistency is simply doing more of what works and less of what doesn't work. Remember it's not the best lawyer who wins the case but the one who is most prepared.

The simple lesson here is you shouldn't focus on what you can't control; rather focus on yourself and taking absolute responsibility for your decisions.

People tend to be overconfident when they have more knowledge and think that they can control events. This belief will result to losses and the risk of ruin in the forex markets. If you can't go against human nature and learn from other peoples mistakes then you my friend will be taught the hard way by the markets.

EMOTIONS AND THEIR EFFECTS IN TRADING

"Never let emotions overpower your intelligence"

Emotion is best defined as disturbance by a very good author Eckhart Tolle in his book The Power of Now. He claims that the word emotion was deprived from **'emovere'** which is a Greek word meaning disturbance. The reason we love this definition is simply because in trading if you become a slave to emotions and concentrate on fulfilling emotions you will end up with no money made at all with frustrations after losing all your money.

- **FEAR AND GREED**

Fear is an emotion that has killed so many dreams and destroyed so many visions; in fact 65% of sources of error in trading are attributed to fear.

It does not only exist in trading but also in life, the surprising fact is that the brain which should be leading us over fear is the same one which is subjected to fear.

In trading fear prevents you from being patient because you think you will miss out, popularly known as the fear of missing out.

Fear also prevents you from sticking to your winners as you think that the trade will eventually go against you so you cut your winners early.

You have to overcome fear not by trying to avoid it but by learning to know that it exists and acting against it when you feel it is the reason behind some reckless decisions.

Greed on the other hand is the reason why so many traders will stick with positions even after their target has been met, the market then reverses and takes out their profits. Also it is the reason why people don't think of risk and over position size and if the trade doesn't turn out well the trader ends up on great loss that damages his account.

We will not tell you what percentage of your account you should risk but always remember that the important aspect in trading is to protect your capital first.

Basically the market movements are driven by only two emotional factors Fear and Greed. These two factors are the ones responsible for the market's volatility, actually the emotion of fear is stronger than greed and that's why markets tend to fall faster than they rise.

- **OVER CONFIDENCE AND EUPHORIA**

Euphoria and over confidence work in tandem. It is your ability to control these two emotions that will make you a very good trader who is not only consistent but also able to control his drawdowns.

Traders will start taking more risks and stop being careful after a string of wins in the markets; you should keep your emotions in check when it comes to trading and be very careful especially after string of wins.

This emotions result in people over estimating their knowledge, underestimating risk and exaggerating their ability to control events.

The markets are uncertain and random; you have to be ready to deal with anything that is happening at the moment and understand that you are not in control of moving the markets.

- **HOW TO DEAL WITH OVER-CONFIDENCE IN FOREX TRADING**

"Always ask yourself what can go wrong in the markets?"

Over confidence as much as fear has been long blamed for failure in the markets. Forex traders will end up on bad trading traits like over position sizing and over trading due to over confidence in the markets. Confidence which is a fine line between fear and overconfidence is what is required for you to become a master at this game**. I will share my different styles of dealing with over confidence in the forex markets**

It is unfortunate that most of us will result to overconfidence after a string of wins in the market and fearful after string of losses in the markets. In a random world, there must always be a series of losses and a series of wins. In order to watch your behavior after a string of wins, the best approach is to use reverse psychology. This means that just when you feel like a god in the markets after several winning trades in a row, you could think of the winning trades like losing trades. Great traders understand that it's only by building good trading traits that they can survive in the markets in the long run. If you think of the winning trades like losing trades, you will be forced to focus on your trading and watch your trading behavior which is very important in the markets.

Complacency is accompanied by lack of focus and a less detailed approach to your work. Good trading is not about overcoming your weaknesses; rather it is a matter of capitalizing on your strength. This means you should be more focused when trading well to understand your feel for the markets and what results to good trading patterns for you. Traders who are keen to try and overcome their weaknesses are using the wrong approach to mastery in the markets, it is important to always seek to work on your weaknesses but the best approach is to capitalize on your strengths and improve on your weaknesses.

Over trading is what will kill most traders who understand the markets and have an edge in the markets. **Selectivity and timing** have resulted to great trading success among many traders in the world. Trading well entails execution of only trades that are favorable in your system and edge in trading. Forex traders will result to **overtrading** only because they think that the pattern they are trading will work all the time, take the example of a trader who greatly relies on Fibonacci ratios while trading, this trader is likely to end up over trading after most of his setups align properly for execution. It is important to factor in the number of trades you are willing to execute within a month in your trading plan as this will enable you to know when you are going overboard in your trading plan.

In conclusion, we can avoid overconfidence from taking over by simply living in the present moment. Thinking about the past and future has trapped most people's lives and this is not good for trading.

Zen in the markets is a good read on how you can be present in the markets and how you can avoid bad disciplines like emotions taking over and other bad habits while trading. Meditation is a good practice for traders each and every day before trading. This will help you remain calm and to take each day with an open mind. The best traders have a way of disengaging for the market and I am glad to say I found mine in meditation.

- **WISHFUL THINKING AND HOPE**

Wishful thinking can be defined as pitting of hope against facts.

Traders often find themselves wishing the market would move in a certain way that could favor their beliefs.

The problem is that our brains are programmed to avoid pain, so most traders find themselves wishing so that they could avoid the pain caused by loss and also avoid taking responsibility for their losses. Instead you should use these losses as a pay for learning the markets.

Hope does the same damage to your account. If you find yourself wishing and hoping then you are probably wrong and should be out of the current position you are in, Markets will move despite your hopes and wishes.

When trading it's always good to deal with the cold hard truth and pain that accompanies the truth. The most important lesson from this section is getting that mind shift from the world of fantasy and wishful thinking to the world of reality.

- **POSITIVE SIDE OF EMOTIONAL TRADING**

We have outlined to you some of the costly emotions in the markets. We however have the positive side of emotions which will work to your favor if you can be able to maximize on them in the markets.

"Great traders are not motivated by making money; to them a feel for the markets is the main goal"

All traders by now are familiar with the great book **Market Wizards** by **Jack Schwagger**. I am interested in the statement of one trader **William Eckhart** who said he would rather bet on someone with a shoe string who can't afford to lose than on a rich man who is not affected by losses. What this trader meant was that if you channel the frustration and pain associated with losses in the markets to trading lessons, you are more likely to learn faster and succeed in the market.

Emotions have been blamed for most of the mistakes in the markets. I believe we can reverse what everyone terms as the cause of failure in the markets, to be the reason for success in the markets. **Worry and fear** are mainly caused as a result of the trader rehearsing what might go wrong in the markets. This worry and fear should therefore force the trader to plan ahead what he will do when the markets do what they are going to do threaten his profit in the markets. This only means that upon every execution a trader should be keen to watch for stop loss points and how to manage the trade efficiently. **A stop loss is point at which your initial trade idea is nullified and becomes wrong in the markets,** only when you fear losses being big than your account allows will you be concerned with setting stop losses and correct position sizing in the markets.

A forex trader will notice his bad trading habits and struggle to change until he experiences pain that will enforces change. Changing behavior is easy, but sustaining change is hard. Traders need to look at emotions in the markets as an aid to help them master trading, rather than as a hindrance to their trading. Great traders are not the traders who don't have losses; rather they are traders who use their losses as pay for learning what not to do in the markets. **Trading is the best career to be involved in if you are constantly seeking improvement (open minded and growth mindset)** I believe every trader always seeks to reach perfection in the markets, but the great traders understand that it is impossible to reach perfection in the markets.

Inspiration and motivation will always be emotional. In trading, two traders execute a break out trade and it turns out to be a false breakout. Both traders end up with losses but one trader uses the loss as an example of false break out and learns how to differentiate the two, the other trader sabotages himself and gets bitter at the market, trying to make money from the market without an opportunity and ends up in more losses. This is a clear example of how emotions resulted to positive behavior and improved trading generally for one trader, while the other trader ended up on the negative side of the market.

Setting goals and accomplishing them will only satisfy you emotionally. It is important as you start every trading week to set small, goals in the markets that will drive you to research and develop good trading habits generally. I will take the example of a trader who sets a goal of banking 100 pips in a trading week, the trader is likely to make better decisions in the market unlike a trader who starts trading without any goals, the trader is likely to trade without any edge or opportunity in the markets to make money.

When setting goals always remember to set achievable goals that will propel you to trade effectively in the markets, setting unrealistic goals is likely not to drive you to trade properly in the markets. Aiming low will not give you the motivation you need to rise and grind, so set your goals effectively.

OVER TRADING

"When the profits of trade happen to be greater than ordinary, over trading becomes a general error both among great and small traders"

Over trading is the one killer that destroys many trading accounts? Too much of everything is poisonous. The driving force behind over trading is over confidence and greed. This two will work in tandem to make traders make this big mistake in the markets.

Over trading means that people place too many trades thinking that the more the trades the more money you will make, that is directly false.

In trading the fewer positions you take the better for you while trading. People also over trade by opening a very big position in relation to their account size and especially after wins in a row, you can also end up over trading once you use very high amounts of leverage.

Always under trade, I have not heard of any trader who over trades and accumulates a fortune. Jim Rogers who is a master trader says that he **always waits till money is fixed in a corner and he just steps there to take it.**

COMMON TRADING BIASES

"Learn how to think, not what to think"

A bias is best defined by Evans Dylan in the book Risk Intelligence **as a tendency to make mistakes of a particular kind, not random errors but ones that are skewed in one direction.** In the financial markets traders often end up on the wrong side of the market due to bad trading habits that are cultivated over time. Traders are humans, they therefore go through biases. In this section we go through some of the common biases that traders go through:

- **CONFIRMATION BIAS**

In the markets traders trade their beliefs about markets. **It is therefore normal for traders to form opinions after observing the charts and reading patterns.** A trader executes a trade after forming hypotheses about the markets, the markets either go his way making the trade a winner or the opposite resulting to a looser. The problem arises when upon execution the trader only looks for information that supports his idea. **This results to locking out information that is contradicting which is more important when trading the financial markets.** In the markets, mental flexibility is underrated by most traders while it could be the best way to learn how to cut losses early and to ride winners. A flexible mind will not hold on to trades only looking for information to support it, instead it will focus on looking for contrary evidence which could make you realize you were wrong. The solution to this bias is to form an open mind upon execution, knowing that the trade could move to any direction and always be keen to look at every tick of the market and what that means.

- **RECENCY BIAS**

Our brains are constantly receiving new information and experiences. Scientific research has proven that our brains put more weight on recent information than on preceding information. Traders have strings of losses and strings of wins in their trades. A string of wins will often result to overconfidence and complacency among traders resulting to over trading and over position sizing which is dangerous for traders. A string of losses will also result to fear of taking opportunities in the markets. **The solution to recency bias is using reverse psychology. This means that you should remain calm and focused, no matter what is going on in your trading.** When you have a winning streak, you can perceive it as a losing streak which will help you focus and remain calm avoiding euphoria**. Behaviors in the markets are very important and it is important for you as a trader to master your behaviors.**

- **LOSS AVERSION**

No one loves losing. We all want to be winners. **Our emotional brain is wired to avoid losses. It is this tendency to avoid losses that will cause traders to execute trades and if the trade is a winner the trader will cut the profits early only to satisfy his emotions.** The same trader will also do the reverse of holding loosing trades for long in the hope of the markets going back, instead of cutting them early. The true test of a trader is how he handles losses and wins. Truly in trading, **"if you bring in normal human tendencies toward trading, then you will gravitate toward the majority and invariably lose"**

LESSONS FROM LEGENDARY TRADERS

In every industry there are general codes of ethic that define **success and failure.** The easiest way to define and differentiate the two is to study those who came before us; in the markets we can get lessons from some of the best traders like Ray Dalio and Jesse Livermore. We can also look at some great failures like the collapse of Lehman Brothers and Long Term Capital Management. We have studied these two patterns and have come up with the following general rules;

- Cut your losses early and ride your winners.
- Stay in the present moment while trading, forget the recent performance and don't be anxious about the future. Focus on what is happening now in the markets.
- Take full responsibility of trading, blame games don't work in the markets.
- It takes **effort, practice and time** but the payoff is great. When beginning your journey in the markets, you must be ready to go through the hard times and put in the work so as to succeed. Success will not just follow you in the markets.
- Don't chase good money after bad; Revenge trading will make you retire faster than you have anticipated in the markets.
- Humility and discipline will take you places in trading; remember good trading is about building and cultivating the winning traits in the markets.
- Don't get attached to money, stay focused on doing the right thing.
- Fear is what results to 65% of errors in trading, so be courageous but not over confident.
- Be market neutral; don't get attached to either side of the market. As a trader you only want movement in order for you to make money, so be keen on the market movement and your opinions about the movement.
- Implementation and execution is more important than the trade analysis, breaking down markets and getting an insight on what is going on is a skill that is easily mastered but execution is something that few are able to master.

- Always speculate and anticipate the market, but don’t always expect to be right. Traders need to be flexible to change their minds when facts change in the markets.
- Effort is the money one pays for development. **Discipline, commitment, hard work, tenacity and consistency** will help you greatly in trading.
- Self-mastery is what you will struggle with to make money in the markets. If you don’t know yourself then the stock market is an expensive place to find out.
- Don’t average losers.
- Be more concerned with your point of exit, rather than the point of entry. This is a synonym of protect your capital in the markets.
- Differentiate between trading based on an edge and trading based on ones ego. If you struggle to cut losses, then it’s pretty clear that you are still trading based on your Ego.
- When there is no directional bias, it is better to stay out and wait for the perfect movements in the markets. Sitting tight and waiting for the right opportunity is what will make you rich in the markets.
- Don’t be perfect, it is virtually impossible. Perfection can’t be achieved in an uncertain environment.

BEGINNERS GUIDE TO RISK AND MONEY MANAGEMENT

"In trading you have to be aggressive and defensive in order to make money''

Risk means more things happening than one can imagine, in trading the financial markets you must have observed that with the markets nothing is guaranteed**. Risk can also be defined as the amount and probability of loss or a series of loss occurring.**

You have to understand and know the risks involved with trading, because this will determine not only how much money you make but most importantly how much you are left with in the long run which is important when it comes to trading. When there is no risk involved, unfortunately no reward is made.

Money management is what will enable you to make money while managing risk and avoid big drawdowns. There are two types of capital which should be managed in the markets, **Emotional capital and the bankroll that is cash**.

The emotional capital will be managed by understanding psychology and getting the mental clarity to prosper and thrive in the financial markets. Trading also has no holy grail; it is all about consistency and minimizing the drawdowns by managing risk.

In the markets waiting for the perfect time and valid reason to pull the trigger you'll find yourself missing the opportunities, you also have to understand that not all bets you make that will turn out well. In every game of chance there is a losing streak you should therefore be prepared for some losing periods. In this business perfection is the enemy of profitability.

Some trades will be good, some will be bad. The good news is it doesn't matter how many are good and how many are bad, what matters is how much you end up with when right and how much you are left with when wrong.

You have to understand that losses are part of the game, if you fail to accept losses as part of the game you better stop trading, this is because you will always encounter losses on your journey as you will be wrong on some of your bets.

Remember just as compound interest works for you in accumulating a fortune, it kills your account once you get big drawdowns which are very hard to recover. In trading sometimes it's not about making money, but protecting what you have.

Risk is accompanied with mistakes, avoiding mistakes makes people stupid and having to be right makes you obsolete, so understand how to manage risk and accept it as an element of trading.

MANAGING RISK AND MONEY

"Don't be a fool and eat like a pigeon and shit like an elephant"

We will look at different market aspects when looking at the concept of risk and money management.

This will guide you and enable you to understand the importance of the following:

- **Importance of trading plan**
- **Journaling and record keeping.**
- **Important factors under risk and money management.**

The following are factors to look at when it narrows down to managing risk and money:

- **Volatility.**
- **Law of Probability**
- **Risk Reward ratio.**
- **Position sizing.**
- **Slippage and spread**
- **Randomness in the markets.**
- **Stop loss placement.**

We will outline each of these elements and guide you on the path to the best methodology of managing risk and money. It is however important to remember that you will have to do some in depth research to understand this risks in a better way.

VOLATILITY

“Volatility is greatest at turning points, diminishing as the new trend emerges”

Volatility can be defined as the range to which a price of a security may increase or decrease.

Volatility is measured by calculating the standard of deviation of the annualized returns over a given period of time.

When trading currencies, different currencies have different forms of volatility. Some currency pairs are highly volatile e.g. EURJPY while others like kiwi are less volatile and slow moving.

The difference in volatility will mean that you should use different position sizes and the stop loss range should be greater in the more volatile assets and less in the less volatile assets.

This will also help in knowing if you are wrong or correct, e.g. you don’t expect to set a 100 pip stop on a slow moving pair like EURGBP and use the same range for Gold which is a fast moving pair.

Once you do this you may not breakeven even with a profitable system this is because the system will not balance the winners and losers which is what is important when trading the financial markets.

So before deciding on position sizing and the stop loss placement remember to factor in volatility so that you can decide the position size, however more volatility does not mean more risk.

PROBABILTIY AND RISK TO REWARD RATIO

“The theory of probability is the only mathematical tool available to help us map the unknown and the uncontrollable. It is fortunate that while this tool is tricky, it is also extraordinarily powerful and convenient”

In the development of a winning system you must have noticed the probability of winning and losing. A good system will have probably anything between 50% and 70% winning rate.

Such a system with a good risk to reward ratio of (1:2) will eventually be profitable, this means that for every dollar lost you make two dollars. This is more like the theory of asymmetric risk reward ratios.

Learn to factor in risk to reward ratios before placing of trades. If you make the same amount when you are right and loose the same amount when you are wrong, then you my friend are setting up yourself for failure.

You have to put in the discipline to stick with your system even during bad times; this is because most traders will start looking for a different system after two loosing trades hence jumping from system to system and ending up in a string of losses and loss of capital.

The percentage of capital you risk will also be determined by how probable you think that the trade will play out. Record keeping and journaling will enable one to decide how much bankroll to risk on one trade as with time you will be able to tell what works and what doesn't work in your system development.

SPREADS AND MARGIN RISK

Spread is the amount your broker gets for offering you an opportunity to trade.

Different brokers and different account sizes have different spreads; you should also factor in this cost while opening a position. This is because during times of great volatility and momentum the brokers offer wider spreads.

Margin risk is the safety you have when your positions are open, if you don't look at the margin keenly and over leverage your account then you will be exposing yourself to great risks of blowing up the account.

Always make sure you are keen on the margin your broker takes. Margin is also affected by the amount of leverage you choose for your account.

Great amounts of leverage mean greater margin is required as you are controlling a bigger account, therefore be keen on leverage as they are correlated to amount of margin.

STOP LOSS PLACEMENT

"If you place your stop loss poorly, 9 out of 10 times it will be taken out"

Traders will often lose money not because they are wrong but primarily because they placed their stop loss too tight or at a point where a market maker will take it out.

When placing your stop always make sure you place it where it needs to be, if you find yourself placing stops based on the amount of money you are willing to loose then you will end up in a pool of losses as most of the times you will place your stop loss too tight to avoid losing money.

Place your stops at places where the market makers won't take them out and also at points where the general masses won't place theirs.

Ensure you give the market time and space to breath once you execute your trades. In the markets every moment is unique; you have to accept the randomness of the markets in order for you to make money.

Randomness means that nothing is guaranteed in the market and not every opportunity will be like every other opportunity that you execute in trading.

POSITION SIZING

"If you don't bet you can't win and if you lose all your chips, you can't bet.

This is one of the very important factors that will determine how much money you end up with after all other factors are considered.

Traders often go wrong in the position sizing aspect; we will look at some factors that can help you in making the decision of how much size should be taken on each position.

- **Volatility**
- **Probability of trade playing out**

- **Percentage of bankroll at risk(risk profile)**
- **System development**

When learning how to trade it is advisable to start with small lots, this will help in your survival and composure in the markets while forward testing your developed system, remember not to risk so much that one trade can ruin you. Also don't risk very little that a win doesn't make any meaning.

SUMMARY

We have listed some of the important factors you need to look at when placing your trades and developing your system under the topic of risk and money management. These are some of the most important factors you need to look at when trading the financial markets and make sure you understand the different aspects for you to be able to develop a system that fits your personality.

<u>BEGINNERS GUIDE TO TRADING PHILOSOPHY AND JOURNALING</u>

“A goal without a plan is merely a wish”

Philosophy can be defined as a theory or attitude that acts as a guiding principle of behavior.

In trading you have to build your own philosophy and believe in your own judgment in order for you to make any money in the markets. You’ll be able to do this by having a trading plan that guides your behavior in the markets and by keeping a record of the trades that you execute in the trading journal.

<u>TRADING PLAN</u>

We all have heard that **failing to plan is planning to fail;** this rule of thumb applies in the markets.

We reckon every successful person always has a goal that drives him every morning when they wake up and start grinding, the same applies to trading. Your trading goal will determine your trading plan. Make sure you set realistic goals as most newbie traders are lost in the lifestyle of wealthy traders forgetting that eventually you will get that level of financial freedom if you concentrate on the right aspects of trading generally. In fact the financial freedom is a reward of doing the right thing in the markets.

You have to make a trading plan and routine depending on the type of trader you decide to be, your risk profile, amount of money you want to make and even depending on your account size.

For us trading the markets we decided to adopt my plan based on various aspects.

The following is a sample trading plan guide that you can use to guide you while making your own trading plan:

Financial assets traded:

You can’t trade all currencies or financial assets; you have to choose some pairs or assets that you will specialize in for you to be able to make money in the markets.

If you decide to trade mainly yen pairs then you should be keen on the Asian session as that will contribute most movement under your category of assets.

If you decide to take on the dollar and the majors then you have to be keen on the European session and the New York session. So before making a decision which markets you will trade make a decision based on your criteria and other factors which assets you will put your time and effort into. Before you decide which assets you will trade take a look at the following aspects?

1. Volatility
2. Account size
3. Goal
4. Personality and time available for you

Methodology:

Day trader, swing trader or scalper? They all do different things in the markets and pay attention to different timeframes and tools while trading the markets.

You have to decide which role you'll take after determining your personality and which methodology you think will make you a heap of money

By the end of the day what really matters in the markets is how much money you end up with, not which method you use.

So you have to find a methodology that suits your personality and routine especially. This is what makes trading primarily difficult because it takes time, effort, persistence and great determination to decide which methodology will make you most money while minimizing drawdown the most.

Time and personality are the two factors that will contribute mainly to this category, but remember that the only thing that matters in trading is how much money you end up with and not which method was used.

Setups:

What are the set ups or scenarios you look for to benefit you in the markets? This will help you greatly in eliminating noise in the markets and help you under trade which is healthy for your trading.

You will also have to decide which criteria should be met before execution of your trades and what will make you get out when you are both wrong or in profit when trading.

Which tools do you use? Is it trend lines, moving averages, key levels, Fibonacci etc. this will help in filtering set ups and enable you to identify which setups work best for you ?

As time progresses you learn pretty fast what really works for you and what doesn't work for you.

Basically in a setup you have to get the following aspects fulfilled?

1. Entry trigger
2. Two exit strategies i.e. one for profits and one for loss.

Trade management:

All trades will not play out as you expect due to the many factors that will influence the markets. The key to long term success in the markets will be accompanied by trade management and how to avoid bad characters like over trading and revenge trading.

Trade management will also help in minimizing of risk as you manage the executed trades.

You have to be willing to deal with the bad hard days of trading. Discipline and flexibility will help you tremendously in managing of your trades and mental state which is very important. Flexibility is important since markets do change and with change we have to be adaptable and make changes as the market progresses.

Trade management will also help you in composure during trading. This is because you will be able to monitor risk and drawdowns while executing trades.

SUMMARY

This are the core principles that you need to make a plan, we have not really dived in deep into details because we believe this can help you greatly in making the plan for your business of trading.

JOURNALING

"Keeping a journal of what's going on your life is a good way to help you distill what is important and what is not.

Journaling is a record of ideas or experiences kept for private use.

When you start a business you always have all the numbers at your head or else the business will tank. In your journey of trading, without a journal you are preparing for death in the markets.

You can't make money in the markets without mastering your mistakes and keeping records in order for you to know if you are trading poorly what's wrong and how to correct your trading. Remember you have to be completely honest with yourself when it comes to trading.

You also observe so many things in the market, through journaling and keeping records that you will always remember once you visit your books again.

Journaling will help you maintain the consistency curve which is also important; it will also help you bring some investors to invest in you.

You also need to believe in yourself, this will help you build confidence as you will be able to watch your decisions and their outcome.

Don't be involved with the biases that affect people in trading, in trading we concentrate on the process of making the decision and not the outcome involved with your decision.

We always do Trade Post Mortem to enable us identify which setups had the best outcomes and which ones are not doing good, with time this will help you in identifying which markets and setups are not good to trade for your criteria and methodology.

It is also important to deal with the truth and reality which help you make your decisions in life as every decision you make has a consequence.

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