

# HIGH PROBABILITY TRADING SETUPS

for the CURRENCY MARKET

Summary (47.67)

Currency	P/L Sell	5 Amt (K)	Av Sell	Sell	Buy	Av Buy	B Amt (K)	P/L Buy	Amt (K)	Gross P/L	Net P/L
EUR/USD 13:01:33				0.0000	1.2792	0.0000	0	0.00	-300	120.00	87.00
Low:1.2774 High:1.2854				116.33	0.00	116.43	100	-85.96	100	-85.96	-85.96
1.27 82 1.27 85				0.0000	1.2351	0.0000	0	0.00	-100	-113.35	-157.15
Low:116.00 High:116.67				1.5791	0.0000	1.5820	100	-234.85	100	-234.85	-258.85
116 42 116 46				0.7628	0.0000	0.7628	100	180.00	100	180.00	174.20
Sell Buy Sell Buy				2.4807	0.0000	2.4807	100	312.83	100	312.83	288.43
GBP/USD 13:01:36											
Low:1.8863 High:1.9001											
1.89 17 1.89 22											
Low:1.2289 High:1.2374											
1.23 64 1.23 69											
Sell Buy Sell Buy											
EUR/JPY 13:00:04											
Low:148.75 High:149.35											
148 84 148 88											
Low:0.7617 High:0.7674											
0.76 26 0.76 30											
Sell Buy Sell Buy											



Kathy Lien  
Boris Schlossberg  
Currency Strategists



Including the Top 10 Trading Rules

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### Boris Schlossberg



Boris Schlossberg serves as the Senior Currency Strategist at FXCM in New York where he shares editorial duties with Kathy Lien for [dailyfx.com](http://dailyfx.com). Dailyfx is one of the pre-eminent FX portal websites in the world attracting more than 3 million readers per month. The site covers currency trading 24 hours per day 5 days a week with 11 daily features 5 weekly pieces and 3 monthly articles. In addition to his daily duties of covering the Asian and European sessions of the FX trading day, Mr. Schlossberg also co-edits The Money Trader with Ms. Lien – one of the few investment advisory letters focusing strictly on the 2 Trillion/day FX market.

Mr. Schlossberg is also the author of “Technical Analysis of the Currency Market: Classic Techniques for Profiting from Market Swings and Trader Sentiment” from John Wiley and Sons (2006). He is a regular guest on CNBC World’s “Foreign Exchange” as well as CNBC television network and a frequent FX commentator for Bloomberg radio. His daily research is quoted by CBS Marketwatch/Dow Jones, Reuters, Bloomberg and Wall Street Journal.

Prior to becoming currency strategist, Mr. Schlossberg traded a variety of financial instruments including equities, options and stock index futures. His articles on subjects such as risk management, trader psychology and structure of modern electronic financial markets have appeared in SFO, Active Trader, Option Trader and Currency Trader magazines. Along with Ms. Lien, he is also the primary contributor to the forex section of the Investopedia website where his library of articles address a variety of technical and fundamental approaches to trade the currency market.

### Kathy Lien



Kathy Lien is Chief Strategist at one of the world's largest retail forex market makers, FXCM in New York and author of the highly acclaimed book, "Day Trading the Currency Market: Technical and Fundamental Strategies to Profit from Market Swings (2005, Wiley)." As Chief Currency Strategist at FXCM, Kathy is responsible for providing research and analysis for DailyFX, one of the most popular currency research websites online. She publishes both technical and fundamental research reports, market commentaries and trading strategies. A seasoned FX analyst and trader, Kathy has direct interbank experience. Prior to joining FXCM, Kathy worked in JPMorgan Chase's Cross Markets and Foreign Exchange Trading groups using both technical and fundamental analysis to trade FX spot and options. She also has experience trading a number of products outside of FX, including interest rate derivatives, bonds, equities and futures. She has taught seminars around the world on day and swing trading the currency market.

Kathy is also one of the authors of Investopedia's Forex Education section and has written for Tradingmarkets.com, the Asia Times Online, Stocks & Commodities Magazine, MarketWatch, ActiveTrader Magazine, Currency Trader, Futures Magazine and SFO. She is frequently quoted by Bloomberg, Reuters, the Wall street Journal, and the International Herald Tribune and frequently appears on CNBC, CBS and Bloomberg Radio. She has also hosted trader chats on EliteTrader, eSignal and FXStreet, sharing her expertise in both technical and fundamental analysis.

Her book "Day Trading the Currency Market: Technical and Fundamental Strategies to Profit from Market Swings" is designed for both the advanced and novice trader. Her easy to read and easy to apply book is filled with actionable strategies.

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### Ten Reasons Why We Love the Currency Market

## Introduction

After having traded everything from stocks to futures to options, the currency market is hands down our favorite market to trade because:

1. You can trade to any style - strategies can be built on five-minute charts, hourly charts, daily charts or even weekly charts
2. Massive amount of information - charts, real-time news, top level research - all available for free
3. All key information is public and disseminated instantly
4. You can collect interest on trades on a daily or even hourly basis
5. Lot sizes can be customized, meaning that you can trade with as little as \$500 dollars at nearly the same execution costs as accounts that trade \$500 million
6. Customizable leverage allows you to be as conservative or as aggressive as you like (cash on cash or 100:1 margin)
7. No commission means that every win or loss is cleanly accounted for in the P&L
8. Trade 24 hours a day with ample liquidity (\$20 million up)
9. No discrimination between going short or long (no uptick rule)
10. You can not lose more capital than you put in (automatic margin call)

This book is designed to help you develop a logical, intelligent approach to currency trading. The systems and ideas presented here stem from years of observation of price action in this market and provide high probability approaches to trading both trend and countertrend setups but they are by no means a surefire guarantee of success. No trade setup is ever 100% accurate. That is why we show you failures as well as successes so that you may learn and understand the profit possibilities, as well as the potential pitfalls of each idea that we present.

However, before we reveal the setups, we would like to share with you our 10 favorite rules for trading success. Having watched the markets on a tick-by-tick basis 24 hours a day, year after year, we, perhaps more than anyone, appreciate the fact that trading is an art rather than a science. Therefore, no rule in trading is ever absolute (except the one about always using stops!) Nevertheless, these 10 rules have served us well across a variety of market environments, always keeping us grounded and out of harm's way. Therefore, we hope that you find both the rules and the high probability setups of interest and value in your pursuit of profit in the currency markets.

We wish you great trading,



**Kathy Lien**



**Boris Schlossberg**



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### Top 10 Trading Rules

# 1. Never Let a Winner Turn Into a Loser

*Repeat after us: Protect your profits. Protect your profits. Protect your profits.*

There is nothing worse than watching your trade be up 30 points one minute, only to see it completely reverse a short while later and take out your stop 40 points lower. If you haven't already experienced this feeling firsthand, consider yourself lucky - it's a woe most traders face more often than you can imagine and is a perfect example of poor money management. The FX markets can move fast, with gains turning into losses in a matter of minutes therefore making it critical to properly manage your capital.

One of our cardinal rules of trading is to protect your profits - even if it means banking only 15 pips at a time. To some, 15 pips may seem like chump change; but if you take 10 trades, 15 pips at a time, that adds up to a respectable 150 points of profits. Sure, this approach may seem as if we are trading like penny-pinching grandmothers, but the main point of trading is to minimize your losses and, along with that, to make money as often as possible. The bottom line is that this is your money. Even if it is money that you are willing to lose, commonly referred to as risk capital, you need to look at it as "you versus the market". Like a soldier on the battlefield, you need to protect yourself first and foremost.

There are two easy ways to never let a winner turn into a loser. The first method is to trail your stop. The second is a derivative of the first, which is to trade more than one lot. Trailing stops requires work but is probably one of the best ways to lock in profits. The key to trailing stops is to set a near-term profit target.

For example, if your "near-term target" is 15 pips, then as soon as you are 15 pips in the money, move your stop to breakeven. If it moves lower and takes out your stop, that is fine, since you can consider your trade a scratch and you end up with no profits or losses. If it moves higher, by each 5-pip increment, you boost up your stop from breakeven by 5 pips, slowly cashing in gains. Just imagine it like a blackjack game, where every time you take in \$100, you move \$25 to your "do not touch" pile.

The second method of locking in gains involves trading more than one lot. If you trade two lots, for example, you can have two separate profit targets. The first target would be placed at a more conservative level that is closer to your entry price, say 15 or 20 pips, while the second lot is much further away through which you are looking to bank a much larger reward-to-risk ratio. Once the first target level is reached, you would move your stop to breakeven, which in essence embodies our first rule: "Never let a winner turn into a loser."

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Of course, 15 pips is hardly a rule written in stone. How much profit you bank and by how much you trail the stop is dependent upon your trading style and the time frame in which you choose to trade. Longer-term traders may want to use a wider first target such as 50 or 100 pips, while shorter-term traders may prefer to use the 15-pip target.

Managing each individual trade is always more art than science. However, trading in general still requires putting your money at risk, so we encourage you to think in terms of protecting profits first and swinging for the fences second. Successful trading is simply the art of accumulating more winners than stops.

## 2. Logic Wins; Impulse Kills

More money has been lost by trading impulsively than by any other means. Ask a novice why he went long on a currency pair and you will frequently hear the answer, “Cause it’s gone down enough - so it’s bound to bounce.” We always roll our eyes at that type of response because it is not based on reason - it’s nothing more than wishful thinking.

We never cease to be amazed how hard-boiled, highly intelligent, ruthless businesspeople behave in Las Vegas. Men and women who would never pay even one dollar more than the negotiated price for any product in their business will think nothing of losing \$10,000 in 10 minutes on a roulette wheel. The glitz, the noise of the pits and the excitement of the crowd turn these sober, rational businesspeople into wild-eyed gamblers. The currency market, with its round-the-clock flashing quotes, constant stream of news and the most liberal leverage in the financial world tends to have the same impact on novice traders.

Trading impulsively is simply gambling. It can be a huge rush when the trader is on a winning streak, but just one bad loss can make the trader give all of the profits and trading capital back to the market. Just like every Vegas story ends in heartbreak, so does every tale of impulse trading. In trading, logic wins and impulse kills.

This maxim isn’t true because logical trading is always more precise than impulsive trading. In fact, the opposite is frequently the case. Impulsive traders can go on stunningly accurate winning streaks, while traders using logical setups can be mired in a string of losses. Reason always trumps impulse because logically focused traders will know how to limit their losses, while impulsive traders are never more than one trade away from total bankruptcy.

Let’s take a look at how each trader may operate in the market. Trader A is an impulsive trader. He “feels” price action and responds accordingly. Now imagine that prices in the EUR/USD move



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sharply higher. The impulsive trader “feels” that they have gone too far and decides to short the pair. The pair rallies higher and the trader is convinced, now more than ever, that it is overbought and sells more EUR/USD, building onto the current short position. Prices stall, but do not retrace. The impulsive trader who is certain that they are very near the top decides to triple up his position and watches in horror as the pair spikes higher, forcing a margin call on his account. A few hours later, the EUR/USD does top out and collapses, causing trader A to pound his fists in fury as he watches the pair sell off without him. He was right on the direction but picked a top impulsively - not logically.

On the other hand, trader B uses both technical and fundamental analysis to calibrate his risk and to time his entries. He also thinks that the EUR/USD is overvalued but instead of prematurely picking a turn at will, he waits patiently for a clear technical signal - like a red candle on an upper Bollinger band or a move in RSI below the 70 level - before he initiates the trade. Furthermore, trader B uses the swing high of the move as his logical stop to precisely quantify his risk. He is also smart enough to size his position so that he does not lose more than 2% of his account should the trade fail. Even if he is wrong like trader A, the logical, methodical approach of trader B preserves his capital, so that he may trade another day, while the reckless, impulsive actions of trader A lead to a margin call liquidation. The point is that trends in the FX market can last for a very long time, so even though picking the very top in the EUR/USD may bring bragging rights, the risk of being premature may outweigh the warm feeling that comes with gloating. Instead, there is nothing wrong with waiting for a reversal signal to reveal itself first before initiating the trade. You may have missed the very top, but profiting from up to 80% of the move is good enough in our book. Although many novice traders may find impulsive trading to be far more exciting, seasoned pros know that logical trading is what puts bread on the table.

## 3. Never Risk More Than 2% Per Trade

This is the most common and yet also the most violated rule in trading and goes a long way towards explaining why most traders lose money. Trading books are littered with stories of traders losing one, two, even five years’ worth of profits in a single trade gone terribly wrong. This is the primary reason why the 2% stop-loss rule can never be violated. No matter how certain the trader may be about a particular outcome, the market, as John Maynard Keynes used to say, “can stay irrational far longer that you can remain solvent.”

Most traders begin their trading career, whether consciously or subconsciously, by visualizing “The Big One” - the one trade that will make them millions and allow them to retire young and live carefree for the rest of their lives. In FX, this fantasy is further reinforced by the folklore of the markets. Who can forget the time that George Soros “broke the Bank of England” by shorting the

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pound and walked away with a cool \$1 billion profit in a single day? But the cold hard truth of the markets is that instead of winning the “Big One”, most traders fall victim to a single catastrophic loss that knocks them out of the game forever. Large losses, as the following table demonstrates are extremely difficult to overcome.

Amount of Equity Loss	Amount of Return Necessary to Re-store to Original
<b>25%</b>	<b>33%</b>
<b>50%</b>	<b>100%</b>
<b>75%</b>	<b>400%</b>
<b>90%</b>	<b>1000%</b>

Just imagine that you started trading with \$1,000 and lost 50%, or \$500. It now takes a 100% gain, or a profit of \$500, to bring you back to breakeven. A loss of 75% of your equity demands a 400% return - an almost impossible feat - just to bring your account back to its initial level. Getting into this kind of trouble as a trader means that, most likely, you have reached the point of no return and are at risk for blowing your account. The best way to avoid such fate is to never suffer a large loss. That is why the 2% rule is so important in trading. Losing only 2% per trade means that you would have to sustain 10 consecutive losing trades in a row to lose 20% of your account. Even if you sustained 20 consecutive losses - and you would have to trade extraordinarily badly to hit such a long losing streak - the total drawdown would still leave you with 60% of your capital intact. While that is certainly not a pleasant position to find yourself in, it means that you only need to earn 80% to get back to breakeven - a tough goal but far better than the 400% target for the trader who lost 75% of his capital.

The art of trading is not about winning as much as it is about not losing. By controlling your losses - much like a business that contains its costs - you can withstand the tough market environments and will be ready and able to take advantage of profitable opportunities once they appear. That's why the 2% rule is the one of the most important rules of trading.

## 4. Trigger Fundamentally, Enter and Exit Technically

Should you trade based upon fundamentals or technicals? This is the \$64 million question that traders have debated for decades and will probably continue to debate for decades to come. Technicals are based on forecasting the future using past price action. Fundamentals, on the other hand, incorporate economic and political news to determine the future value of the currency pair. The question of which is better is far more difficult to answer. We have often seen fundamental factors rapidly shift the technical outlook, or technical factors explain a price move that fundamentals cannot.

So our answer to the question is to use both. We know all too well that both are important and have a hand in impacting price action. The real key, however, is to understand the benefit of each style and to know when to use each discipline. Fundamentals are good at dictating the broad themes in the market, while technicals are useful for identifying specific entry and exit levels. Fundamentals do not change in the blink of an eye: in the currency markets, fundamental themes can last for weeks, months and even years.

For example, one of the biggest stories of 2005 was the U.S. Federal Reserve's aggressive interest rate tightening cycle. In the middle of 2004, the Federal Reserve began increasing interest rates by quarter-point increments. They let the market know very early on that they were going to be engaging in a long period of tightening, and as promised, they increased interest rates by 200 basis points in 2005. This policy created an extremely dollar-bullish environment in the market that lasted for the entire year. Against the Japanese Yen, whose central bank held rates steady at zero throughout 2005, the dollar appreciated 19% from its lowest to highest levels. USD/JPY was in a very strong uptrend throughout the year, but even so, there were plenty of retraces along the way. These pullbacks were perfect opportunities for traders to combine technicals with fundamentals to enter the trade at an opportune moment. Fundamentally, we knew that we were in a very dollar-positive environment; therefore technically, we looked for opportunities to buy on dips rather than sell on rallies. A perfect example was the rally from 101.70 to 113.70. The retracement paused right at the 38.2% Fibonacci support, which would have been a great entry point and a clear example of a trade that was based upon fundamentals but looked for entry and exit points based upon technicals. In the USD/JPY trade, trying to pick tops or bottoms during that time would have been difficult. However, with the bull trend so dominant, the far easier and smarter trade was to look for technical opportunities to go with the fundamental theme and trading with the market trend rather than trying to fade it.

## 5. Always Pair Strong With Weak

Every baseball fan has a favorite team that he knows well. The true fan knows who the team can easily beat, who they will probably lose against and who poses a big challenge. Placing a gentleman's bet on the game, the baseball fan knows the best chance for success occurs against a much weaker opponent. Although we are talking about baseball, the logic holds true for any contest. When a strong army is positioned against a weak army, the odds are heavily skewed toward the strong army winning.

This is the way we have to approach trading.

When we trade currencies, we are always dealing in pairs - every trade involves buying one currency and shorting another. So the implicit bet is that one currency will beat out the other. If this is the way the FX market is structured, then the highest probability trade will be to pair a strong currency with a weak currency. Fortunately, in the currency market we deal with countries whose economic outlooks do not change instantaneously. Economic data from the most actively traded currencies are released every single day, and they act as a scorecard for each country. The more positive the reports, the better or stronger a country is doing; on the flip side, the more negative reports, the weaker the country is performing.

Pairing a strong currency with a weak currency has much deeper ramifications than just the data itself. Each strong report gives a better reason for the central bank to increase interest rates, which in turn would increase the yield of the currency. In contrast, the weaker the economic data, the less flexibility a country's central bank has in raising interest rates, and in some instances, if the data comes in extremely weak, the central bank may even consider lowering interest rates. The future path of interest rates is one of the biggest drivers of the currency market because it increases the yield and attractiveness of a country's currency.

In addition to looking at how data is stacking up, an easier way to pair strong with weak may be to compare the current interest rate trajectory for a currency. For example, EUR/GBP - which is traditionally a very range-bound currency pair - broke out in the first quarter of 2006. The breakout occurred to the upside because Europe was just beginning to raise interest rates as economic growth was improving. On the flip side, the U.K. raised interest rates throughout 2004 and the early part of 2005 and ended its tightening cycle long ago. In fact, U.K. officials lowered interest rates in August of 2005 and were looking to lower them again following weak economic data. The sharp contrasts in what each country was doing with interest rates forced the EUR/GBP materially higher and even turned the traditionally range-bound EUR/GBP into a mildly trending currency pair for a few months. The shift was easily anticipated, making EUR/GBP a clear trade based upon pairing

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a strong currency with a weak currency.

Because strength and weakness can last for some time as economic trends evolve, pairing the strong with the weak currency is one of the better ways for traders to gain an edge in the currency market

## 6. Being Right but Being Early Simply Means That You Are Wrong

There is a great Richard Prior routine in which the comic lectures the audience that the only way to reply when caught cheating red-handed by one's spouse is by calmly stating, "Who are you going to believe? Me? Or your lying eyes?" While this line always gets a huge laugh from the crowd, many traders unfortunately take this advice to heart. The fact of the matter is that eyes do not lie. If a trader is short a currency pair and the price action moves against him, relentlessly rising higher, the trader is wrong and needs to admit that fact, sooner rather than later.

In FX, trends can last far longer than seem reasonable. For example, in 2004 the EUR/USD kept rallying - rising from a low of 1.2000 all the way to 1.3600 over a period of just two months. Traders looking at the fundamentals of the two currencies could not understand the reasons behind the move since all signs pointed to dollar strength.

True enough, the U.S. was running a record trade deficit, but it was also attracting capital from Asia to offset the shortfall. In addition, U.S. economic growth was blazing in comparison to the Eurozone. U.S. GDP was growing at a better than 3.5% annual rate compared to barely 1% in the Eurozone. The Fed had even started to raise rates, equalizing the interest rate differential between the euro and the greenback. Furthermore, the extremely high exchange rate of the euro was strangling European exports - the one sector of the Eurozone economy critical to economic growth.

As a result, U.S. unemployment rates kept falling, from 5.7-5.2%, while German unemployment was reaching post-World War II highs, printing in the double digits. In short, dollar bulls had many good reasons to sell the EUR/USD, yet the currency pair kept rallying. Eventually, the EUR/USD did turn around, retracing the whole 2004 rally to reach a low of 1.1730 in late 2005. But imagine a trader shorting the pair at 1.3000. Could he or she have withstood the pressure of having a 600-point move against a position? Worse yet, imagine someone who was short at 1.2500 in the fall of 2004. Could that trader have taken the pain of being 1,100 points in drawdown?

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The irony of the matter is that both of those traders would have profited in the end. They were right but they were early. Yet in currency markets, unlike in horseshoes, close is not good enough. The FX market is highly leveraged, with default margins set at 100:1. Even if the two traders above used far more conservative leverage of 10:1, the drawdown to their accounts would have been 46% and 88%, respectively. In FX, successful directional trades not only need to be right in analysis, they need to be right, in timing as well.. That's why believing "your lying eyes" is crucial to successful trading. If the price action moves against you, even if the reasons for your trade remain valid, trust your eyes, respect the market and take a modest stop. In the currency market, being right and being early is the same thing as being wrong.

## 7. Know the Difference Between Scaling In and Adding to a Loser and Never Make That Mistake

One of the biggest mistakes that we have seen traders make is to keep adding to a losing position, desperately hoping for a reversal. As traders increase their exposure while price travels in the wrong direction, their losses mount to a point where they are forced to close out their position at a major loss or wait numbly for the inevitable margin call to automatically do it for them. Typically in these scenarios, the initial reasoning for the trade has disappeared, and a smart trader would have closed out the position and moved on. However, some traders find themselves adding into the position long after the reason for the trade has changed, hoping that by magic or chance things will eventually turn their way.

We liken this to the scenario where you are driving in a car late at night and are not sure whether you are on the right road or not. When this happens, you are faced with two choices. One is to keep on going down the road blindly and hope that you will find your destination before ending up in another state. The other is to turn the car around and go back the way you came, until you reach a point from where you can actually find the way home.

This is the difference between stubbornly proceeding in the wrong direction and cutting your losses short before it becomes too late. Admittedly, you might eventually find your way home by stumbling along back roads - much like a trader could salvage a bad position by catching an unexpected turnaround. However before that time comes, the driver could very well have run out of gas, much like the trader can run out of capital. Adding to a losing position that has gone beyond



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the point of your original risk is the wrong way to trade.

There are, however, times when adding to a losing position is the right way to trade. This type of strategy is known as scaling in. The difference between adding to a loser and scaling in is your initial intent BEFORE you place the trade. If your intention is to ultimately buy a total of one regular 100,000 lot and you choose to establish a position in clips of 10,000 lots to get a better average price - instead of the full amount at the same time - this is called scaling in. This is a popular strategy for traders who are buying into a retracement of a broader trend and are not sure how deep the retracement will be.; Therefore, the trader will choose to scale down into the position in order to get a better average price. The key is that the reasoning for this approach is established before the trade is placed and so is the “ultimate stop” on the entire position. In this case, intent is the main difference between adding to a loser and scaling in.

## 8. What Is Mathematically Optimal Is Psychologically Impossible

Novice traders who first approach the markets will often design very elegant, very profitable strategies that appear to generate millions of dollars on a computer backtest. The majority of such strategies have extremely impressive win-loss and profit ratios, often demonstrating \$3 of wins for just \$1 of losses. Armed with such stellar research, these newbies fund their FX trading accounts and promptly proceed to lose all of their money. Why? Because trading is not logical but instead psychological in nature, and emotion will always overwhelm the intellect in the end, typically forcing the worst possible move out of the trader at the wrong time.

As E. Derman, head of quantitative strategies at Goldman Sachs, once noted, “In physics you are playing against God, who does not change his mind very often. In finance, you are playing against God’s creatures, whose feelings are ephemeral, at best unstable, and the news on which they are based keeps streaming in.” This is the fundamental flaw of most beginning traders. They believe that they can “engineer” a solution to trading and set in motion a machine that will harvest profits out of the market. But trading is less of a science than it is an art; and the sooner traders realize that they must compensate for their own humanity, the sooner they will begin to master the intricacies of trading.

Here is one example of why in trading what is mathematically optimal is often psychologically impossible. The conventional wisdom in the markets is that traders should always trade with a 2:1 reward-to-risk ratio. On the surface this appears to be a good idea. After all, if the trader is accurate

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only 50% of the time, over the long run she or he will be enormously successful with such odds. In fact, with a 2:1 reward-to-risk ratio, the trader can be wrong 6.5 times out of 10 and still make money. In practice however, this is quite difficult to achieve.

Imagine the following scenario. You place a trade in GBP/USD. Let's say you decide to short the pair at 1.7500 with a 1.7600 stop and a target of 1.7300. At first, the trade is doing well. The price moves in your direction, as GBP/USD first drops to 1.7400, then to 1.7460 and begins to approach 1.7300. At 1.7320, the GBP/USD decline slows and starts to turn back up. Price is now 1.7340, then 1.7360, then 1.7370. But you remain calm. You are seeking a 2:1 reward to risk. Unfortunately, the turn in the GBP/USD has picked up steam; before you know it, the pair not only climbs back to your entry level but then swiftly rises higher and stops you at 1.7600. You are left with the realization that you let a 180-point profit turn into a 100-point loss. In effect, you just created a -280-point swing in your account. This is trading in the real world, not the idealized version presented in textbooks. This is why many professional traders will often scale out of their positions, taking partial profits far sooner than two times risk, a practice that often reduces their reward-to-risk ratio to 1.5 or even lower. Clearly that's a mathematically inferior strategy, but in trading, what's mathematically optimal is not necessarily psychologically possible.

## 9. Risk Can Be Predetermined; But Reward Is Unpredictable

If there is one inviolable rule in trading, it must be “stick to your stops”. Before entering every trade, you must know your pain threshold. This is the best way to make sure that your losses are controlled and that you do not become too emotional with your trading.

Trading is hard; there are more unsuccessful traders than there are successful ones. But more often than not, traders fail not because their idea is wrong, but because they became too emotional in the process. This failure stems from the fact that they closed out their trade too early, or they let their losses run too extensively. Risk **MUST** be predetermined. The most rational time to consider risk is before you place the trade - when your mind is unclouded and your decisions are unbiased by price action. On the other hand, if you have a trade on, of course you want to stick it out until it becomes a winner, but unfortunately that does not always happen. You need to figure out what the worst case scenario is for the trade, and place your stop based on a monetary or technical level.

Once again, we stress that risk **MUST** be predetermined before you enter into the trade and you **MUST** stick to its parameters. Do not let your emotions force you to change your stop prematurely.

## Part 1

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### Top 10 Trading Rules

Every trade, no matter how certain you are of its outcome, is simply an educated guess. Nothing is certain in trading. There are too many external factors that can shift the movement in a currency. Sometimes fundamentals can shift the trading environment, and other times you simply have unaccountable factors, such as option barriers, the daily exchange rate fixing, central bank buying etc. Make sure you are prepared for these uncertainties by setting your stop early on.

Reward, on the other hand, is unknown. When a currency moves, the move can be huge or small. Money management becomes extremely important in this case. Referencing our rule of “never let a winner turn into a loser”, we advocate trading multiple lots. This can be done on a more manageable basis using mini-accounts. This way, you can lock in gains on the first lot and move your stop to breakeven on the second lot - making sure that you are only playing with the houses money - and ride the rest of the move using the second lot.

The FX market is a trending market; and trends can last for days, weeks or even months. This is a primary reason why most black boxes in the FX market focus exclusively on trends. They believe that any trend moves they catch can offset any whipsaw losses made in range-trading markets. Although we believe that range trading can also yield good profits, we recognize the reason why most large money is focused on looking for trends. Therefore, if we are in a range-bound market, we bank our gain using the first lot and get stopped out at breakeven on the second, still yielding profits. However, if a trend does emerge, we keep holding the second lot into what could potentially become a big winner.

Half of trading is about strategy, the other half is undoubtedly about money management. Even if you have losing trades, you need to understand them and learn from your mistakes. No strategy is foolproof and works 100% of the time. However, if the failure is in line with a strategy that has worked more often than it has failed for you in the past, then accept that loss and move on. The key is to make your overall trading approach meaningful but to make any individual trade meaningless. Once you have mastered this skill, your emotions should not get the best of you, regardless of whether you are trading \$1,000 or \$100,000. Remember: In trading, winning is frequently a question of luck, but losing is always a matter of skill.

## 10. No Excuses, Ever

One time our boss invited us into his office to discuss a trading program that he wanted to set up. “I have one rule only,” he noted. Looking us straight in the eye, he said, “no excuses.” Instantly we understood what he meant. Our boss wasn’t concerned about traders booking losses. Losses are a given part of trading and anyone who engages in this enterprise understands and accepts that fact. What our boss wanted to avoid were the mistakes made by traders who deviated from their

## Part 1

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### Top 10 Trading Rules

trading plan. It was perfectly acceptable to sustain a drawdown of 10% if it was the result of five consecutive losing trades that were stopped out at 2% loss each. However, it was inexcusable to lose 10% on one trade because the trader refused to cut his losses, or worse yet, added to a position beyond his risk limits. Our boss knew that the first scenario was just a regular part of business, while the second one would ultimately bring about the blow up of the entire account.

In the quintessential '80s movie, "The Big Chill", Jeff Goldblum's character tells Kevin Kline's that "rationalization is the most powerful thing on earth." Surprised, Kline looks up at Goldblum and the latter explains, "As human beings we can go for a long time without food or water, but we can't go a day without a rationalization." This quote has stuck a chord with us because it captures the ethos behind the "no excuses" rule. As traders, we must take responsibility for our mistakes. In a business where you either adapt or die, the refusal to acknowledge and correct your shortcomings will ultimately lead to disaster.

Markets can and will do anything. Witness the blowup of Long Term Capital Management (LTCM) - at one time one of the most prestigious hedge funds in the world - whose partners included several Nobel Prize winners. In 1998 LTCM went bankrupt, nearly bringing the global financial markets to their knees when a series of complicated interest rate plays generated billions of dollars worth of losses in a matter of days. Instead of accepting the fact that they were wrong, LTCM traders continued to double up on their positions, believing that the markets would eventually turn their way. It took the Federal Reserve Bank of New York and a series of top-tier investment banks to step in and stem the tide of losses until the portfolio positions could be unwound without further damage. In post-debacle interviews, most LTCM traders refused to acknowledge their mistakes, stating that the LTCM blowup was the result of extremely unusual circumstances unlikely to ever happen again. LTCM traders never learned the "no excuses" rule, and it cost them their capital.

The "no excuses" rule is most applicable to those times when the trader does not understand the price action of the markets. If, for example, you are short a currency because you anticipate negative fundamental news and that news indeed occurs, but the currency rallies instead, you must get out right away. If you do not understand what is going on in the market, it is always better to step aside and not trade. That way you will not have to come up with excuses for why you blew up your account. No excuses. Ever. That's the rule professional traders live by.

## Part 2

# Trading Setups

20	Five-Minute “Momo” Trade
27	“Do the Right Thing” CCI Trade
34	Moving Average MACD Combo
41	RSI Rollercoaster
49	Pure Fade
56	The Memory of Price
68	Seven-Day Extension Fade
76	Turn to Trend

# 1. Five-Minute “Momo” Trade

Some traders are extremely patient and love to wait for the perfect setup while others are extremely impatient and need to see a move happen in the next few minutes or hours or else they are quick to abandon their positions. These impatient traders are perfect momentum traders because they wait for the market to have enough strength to push a currency in the desired direction and piggyback on the momentum in hopes for an extension move as momentum continues to build. However, once the move shows signs of losing strength, our impatient momentum traders will also be the first to jump ship so a true momentum strategy needs to have solid exit rules to protect profits while at the same time be able to ride as much of the extension move as possible.

We developed a great momentum strategy that we call the “Five Minute Momo Trade” because we look for a momentum or “momo” burst on very short term 5 minute charts. We lay on two indicators, the first of which is the 20-period EMA (Exponential Moving Average). We use the exponential moving average over the simple moving average because it places higher weight on recent movements, which is what we need for fast momentum trades. The moving average is used to help us determine the trend. The second indicator that we use is the MACD (Moving Average Convergence Divergence) histogram which helps us gauge momentum. The settings for the MACD histogram is the default, which is first EMA = 12, second EMA = 26, Signal EMA = 9, all using the close price.

This strategy waits for a reversal trade but only takes it when momentum supports the reversal move enough to create a larger extension burst. The position is exited in two separate segments, the first half helps us lock in gains and ensures that we never turn a winner into a loser. The second half lets us attempt to catch what could become a very large move with no risk since we already moved our stop to breakeven.

## Rules for a Long Trade

- 1) Look for currency pair to be trading below the 20-period EMA and MACD to be negative
- 2) Wait for price to cross above the 20-period EMA, make sure that MACD is either in the process of crossing from negative to positive or have crossed into positive territory no longer than 5 bars ago
- 3) Go long 10 pips above the 20-period EMA
- 4) For aggressive trade, place stop at swing low on 5 minute chart. For conservative trade, place stop 20 pips below 20-period EMA



## Part 2

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### High Probability Trading Setups

- 5) Sell half of position at entry plus amount risked, move stop on second half to breakeven
- 6) Trail stop by higher of breakeven or 20-period EMA minus 15 pips

#### **Rules for a Short Trade**

- 1) Look for currency pair to be trading above the 20-period EMA and MACD to be positive
- 2) Wait for price to cross below the 20-period EMA, make sure that MACD is either in the process of crossing from positive to negative or have crossed into negative territory no longer than 5 bars ago
- 3) Go short 10 pips below the 20-period EMA
- 4) For aggressive trade, place stop at swing high on 5 minute chart. For conservative trade, place stop 20 pips above 20-period EMA
- 5) Buy back half of position at entry minus amount risked, move stop on second half to breakeven
- 6) Trail stop by lower of breakeven or 20-period EMA plus 15 pips

Now let's explore some examples:

## Part 2

### High Probability Trading Setups

#### Setup 1 - Five-Minute “Momo” Trade, EUR/USD

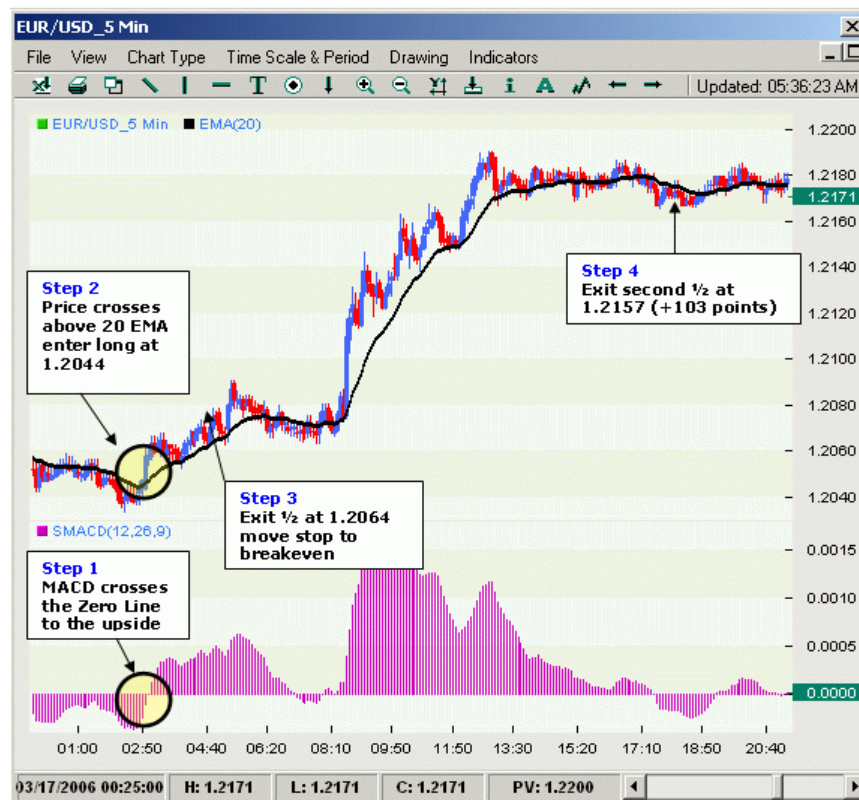


Figure 1 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Our first example is the EUR/USD on 3/16/06, when we see the price move above the 20-period EMA as the MACD histogram crosses above the zero line. Although there were a few instances of the price attempting to move above the 20-period EMA between 00:30 and 02:00 EST, a trade was not triggered at that time because the MACD histogram was below the zero line.

We waited for the MACD histogram to cross the zero line and when it did, the trade was triggered at 1.2044. We enter at  $1.2046 + 10 \text{ pips} = 1.2056$  with a stop at  $1.2046 - 20 \text{ pips} = 1.2026$ . Our first target is  $1.2056 + 30 \text{ pips} = 1.2084$ . It gets triggered approximately 2 and a half hours later. We exit half of the position and trail the remaining half by the 20-period EMA minus 15 pips. The second half is eventually closed at 1.2157 at 21:35 EST for a total profit on the trade of 65.5 pips.

## Part 2

### High Probability Trading Setups

#### Setup 1 - Five-Minute “Momo” Trade, USD/JPY



Figure 1 - 2

Source: Fxtrik Intellichart, Copyright 2001 - 2005 Fxtrik.com, Inc.

The next example in the chart above is USD/JPY on 3/21/06, when we see the price move above the 20-period EMA. Like in the previous EUR/USD example, there were also a few instances that the price crossed above the 20-period EMA right before our entry point, but we did not take the trade because the MACD histogram was below the zero line.

The MACD turned first, so we waited for the price to cross the EMA by 10 pips and when it did, the trade was entered into at 116.67 (EMA was at 116.57). The math is a bit more complicated on this one. The stop is at the 20-EMA minus 20 pips or  $116.57 - 20 \text{ pips} = 116.37$ . Our first target is entry plus amount risked or  $116.67 + (116.67 - 116.37) = 116.97$ . It gets triggered five minutes later. We exit half of the position and trail the remaining half by the 20-period EMA minus 15 pips. The second half is eventually closed at 117.07 at 18:00 EST for a total average profit on the trade of 35 pips. Although the profit was not as attractive as the first trade, the chart shows a clean and smooth move that indicates that price action conformed well to our rules.

## Part 2

### High Probability Trading Setups

#### Setup 1 - Five-Minute “Momo” Trade, NZD/USD



Figure 1 - 3

Source: FXTrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

On the short side, our first example is the NZD/USD on 3/20/06. We see the price cross below the 20-period EMA. However the MACD histogram is still positive, so we wait for it to cross below the zero line 25 minutes later. Our trade is then triggered at 0.6294. Like the earlier USD/JPY example, the math is a bit messy on this one since the cross of the moving average did not occur at the same time as when MACD moved below the zero line like in it did in our first EUR/USD example.

So we enter at 0.6294. Our stop is the 20-EMA plus 20 pips. At the time, the 20-EMA was at 0.6301, so that puts our entry at 0.6291 and our stop at  $0.6301 + 20\text{pips} = 0.6321$ . Our first target is the entry price minus the amount risked or  $0.6291 - (0.6321 - 0.6291) = 0.6261$ . The target is hit 2 hours later and the stop on the second half was moved to breakeven. We then proceed to trail the second half of the position by the 20-period EMA plus 15 pips. The second half is then closed at 0.6262 at 7:10 EST for a total profit on the trade of 29.5 pips.

## Part 2

### High Probability Trading Setups

#### Setup 1 - Five-Minute “Momo” Trade, GBP/USD

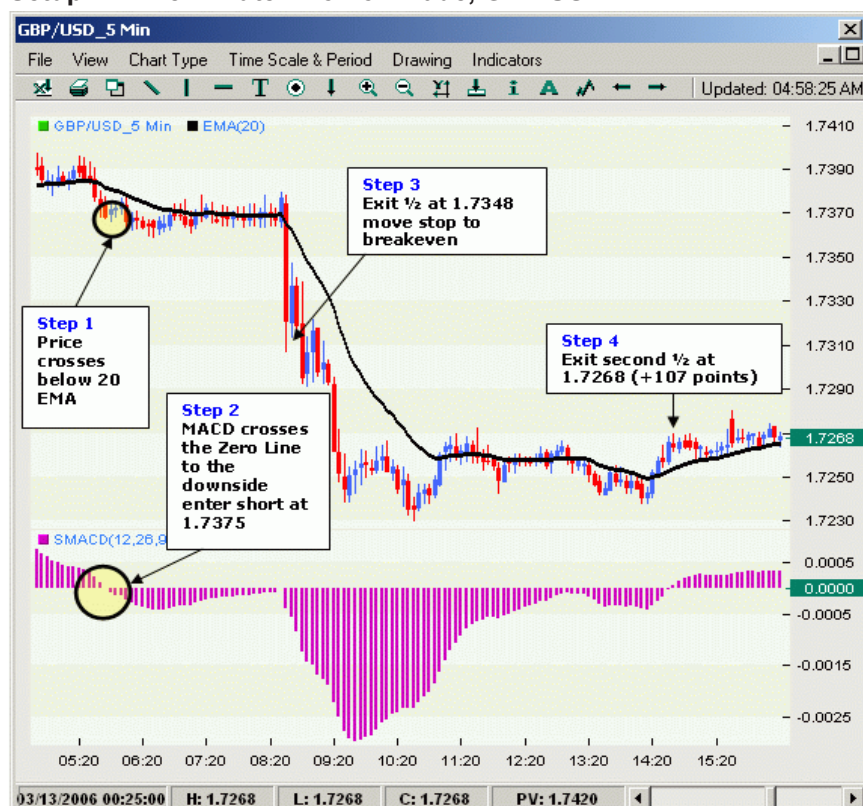


Figure 1 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The second based upon an opportunity that developed on 3/10/06 in the GBP/USD. In the chart above, the price crosses below the 20-period EMA and we wait 10 minutes later for the MACD histogram to move into negative territory whereby triggering our entry order at 1.7375. Based upon the rules above, as soon as the trade is triggered, we put our stop at the 20-EMA plus 20 pips or  $1.7385 + 20 = 1.7405$ . Our first target is the entry price minus the amount risked or  $1.7375 - (1.7405 - 1.7375) = 1.7345$ . It gets triggered shortly thereafter. We then proceed to trail the second half of the position by the 20-period EMA plus 15 pips. The second half of the position is eventually closed at 1.7268 at 14:35 EST for a total profit on the trade of 68.5 pips. Coincidentally enough, the trade was also closed at the exact moment when the MACD histogram flipped into positive territory.

As you can see, the Five Minute Momo Trade is an extremely powerful strategy to capture momentum based reversal moves. However, it does not always work and it is important to explore an example where it fails to understand why.



## Part 2

### High Probability Trading Setups

#### Setup 1 - Five-Minute “Momo” Trade, EUR/CHF



Figure 1 - 5

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The final example of the Five Minute Momo Trade is EUR/CHF on 3/21/06. In the chart above the price crosses below the 20-period EMA and we wait 20 minutes later for the MACD histogram to move into negative territory, putting our entry order at 1.5711. We place our stop at the 20-EMA plus 20 pips or  $1.5721 + 20 = 1.5741$ . Our first target is the entry price minus the amount risked or  $1.5711 - (1.5741 - 1.5711) = 1.5681$ . The price trades down to a low of 1.5696, which is not low enough to reach our trigger. It then proceeds to reverse course, eventually hitting our stop, causing a total trade loss of 30 pips.

When trading the Five Minute Momo strategy the most important thing to be wary of is trading ranges that are too tight or too wide. In quiet trading hours where the price simply fluctuates around the 20-EMA, the MACD histogram may flip back and forth causing many false signals. Alternatively, if this strategy is implemented in a currency paid with a trading range that is too wide, the stop might be hit **before the target is triggered**.



## Part 2

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### High Probability Trading Setups

## 2. “Do the Right Thing” CCI Trade

Often in life the right action is the hardest to take. The same dynamic occurs in trading. For most traders it is extremely difficult to buy tops and sell bottoms because from a very early age we are conditioned to look for value and buy “cheap” while selling “dear”. That is why although most traders proclaim their love for trading with the trend, in reality the majority love to pick tops or bottoms. While these types of “turn” trades can be very profitable (and show you several setups that succeed with this approach), turn trading can sometimes seem like a Sisyphean task as price trends relentlessly in one direction, constantly stopping out the bottom and top pickers. Sometimes it is much easier and far more profitable to go with the flow. Yet most traders are still reluctant to buy breakouts for fear of being the last one to the party before prices reverse with a vengeance.

How can we trade breakouts confidently and successfully? “Do the right thing” is a setup designed to deal with just such a predicament. It tells the trader to buy or sell when most are averse to doing so. Furthermore, it puts the trader on the right side of the trend at a time when many other traders are trying to fade the price action. The capitulation of these top and bottom pickers in the face of a massive buildup of momentum forces a covering of positions, allowing you to exit profitably within a very short period of time after putting on a trade.

“Do the right thing” employs a rarely used indicator in FX called the commodity channel index (CCI), which was invented by Donald Lambert in 1980 and was originally designed to solve engineering problems regarding signals. The primary focus of CCI is to measure the deviation of the price of the currency pair from its statistical average. As such, CCI is an extremely good and sensitive measure of momentum and helps us to optimize only the highest probability entries for our setup.

Without resorting to the mathematics of the indicator, please note that CCI is an unbounded oscillator with any reading of +100 typically considered to be overbought and any reading of -100 oversold. For our purposes, however, we will use these levels as our trigger points as we put a twist on the traditional interpretation of CCI. We actually look to buy if the currency pair makes a new high above 100 and sell if the currency pair makes a new low below -100. In “do the right thing” we are looking for new peaks or spikes in momentum that are likely to carry the currency pair higher or lower. The thesis behind this setup is that much like a body hurtled in motion will remain so until it’s slowed by counterforces, new highs or lows in CCI will propel the currency

further in the direction of the move before new prices finally put a halt to the advance or the decline.

## Part 2

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### High Probability Trading Setups

#### Rules for the Long Trade

1. On the daily or the hourly charts place the CCI indicator with standard input of 20.
2. Note the very last time the CCI registered a reading of greater than +100 before dropping back below the +100 zone.
3. Take a measure of the peak CCI reading and record it.
4. If CCI once again trades above the +100 and if its value exceeds the prior peak reading, go long at market at the close of the candle.
5. Measure the low of the candle and use it as your stop.
6. If the position moves in your favor by the amount of your original stop, sell half and move stop to breakeven.
7. Take profit on the rest of the trade when position moves to two times your stop.

#### Rules for the Short Trade

1. On the daily or the hourly charts place the CCI indicator with standard input of 20.
2. Note the very last time the CCI registered a reading of less than -100 before poking above the -100 zone.
3. Take a measure of the peak CCI reading and record it.
4. If CCI once again trades below the -100 and if its value exceeds the prior low reading, go short at market at the close of the candle.
5. Measure the high of the candle and use it as your stop.
6. If the position moves in your favor by the amount of your original stop, sell half and move the stop on the remainder of the position to breakeven.
7. Take profit on the rest of the trade when position moves to two times your stop.

## Part 2

### High Probability Trading Setups

Now let's take a look at how this setup works on the longer and the shorter time frames:

#### Setup 2 - "Do the Right Thing" CCI Trade, EUR/USD



Figure 2 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

In this daily chart of the EUR/USD pair we see that the former peak high above the CCI +100 level was recorded on September 5, 2005, when it reached a reading of 130.00. Not until more than three months later on December 13, 2005, did the CCI produce a value that would exceed this number. Throughout this time we can see that EUR/USD was in a severe decline with many false breakouts to the upside that fizzled as soon as they appeared on the chart. On December 13, 2005, however, CCI hit 162.61 and we immediately went long on the close at 1.1945 using the low of the candle at 1.1906 as our stop. Our first target was 100% of our risk, or approximately 40 points. We exited half the position at 1.1985 and the second half of the position at two times our risk at 1.2035. Our total reward-to-risk ratio on this trade was 1.5:1, meaning that if we were merely 50% accurate, the setup would have positive expectancy. Note also that we were able to capture our gains in less than 24 hours as the momentum of the move carried our position to profit very quickly.

## Part 2

### High Probability Trading Setups

#### Setup 2 - “Do the Right Thing” CCI Trade, EUR/USD



Figure 2 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

For those traders who do not like to wait nearly a quarter of a year between setups, the hourly chart offers far more opportunities of the “do the right thing” setup. It is still infrequent, which is one of the reasons that makes this setup so powerful (the common wisdom in trading is: the rarer the trade the better the trade). Nevertheless it occurs on the hourly charts far more often than on the dailies. In the above example, we look at the hourly chart of the EUR/USD between March 24 and March 28 of 2006. At 1pm on March 24, 2006, the EUR/USD reaches a CCI peak of 142.96. Several days later at 4am on March 28, 2006, the CCI reading reaches a new high of 184.72. We go long at market on the close of the candle at 1.2063. The low of the candle is 1.2027 and we set our stop there. The pair consolidates for several hours and then makes a burst to our first target of 1.2103 at 9am on March 28, 2006. We move the stop to breakeven to protect our profits and are stopped out a few hours later, banking 40 pips of profit. As the saying goes, half a loaf is better than none, and it is amazing how they can add up to a whole bakery full of profits if we simply take what the market gives us.

## Part 2

### High Probability Trading Setups

Now let's look at some short examples:

#### Setup 2 - "Do the Right Thing" CCI Trade, USD/CHF



Figure 2 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Here is an example of a short in USD/CHF trade on the dailies that employs this approach in reverse. On October 11, 2004 USD/CHF makes a CCI low of -131.05. A few days later, on October 14, 2004, the CCI prints at -133.68. We enter short at market on the close of the candle at 1.2445. Our stop is the high of that candle at 1.2545. Our first exit is hit just two days later at 1.2345. We stay in the trade with the rest of the position and move the stop to breakeven. Our second target is hit on October 19, 2004 - no more than five days after we've entered the trade. Total profit on the trade? 300 points. Our total risk was only 200 points, and we never even experienced any serious drawdown as the momentum pulled prices further down. The key is high probability, and that is exactly what the "do the right thing" setup provides.



## Part 2

### High Probability Trading Setups

#### Setup 2 - “Do the Right Thing” CCI Trade, EUR/JPY

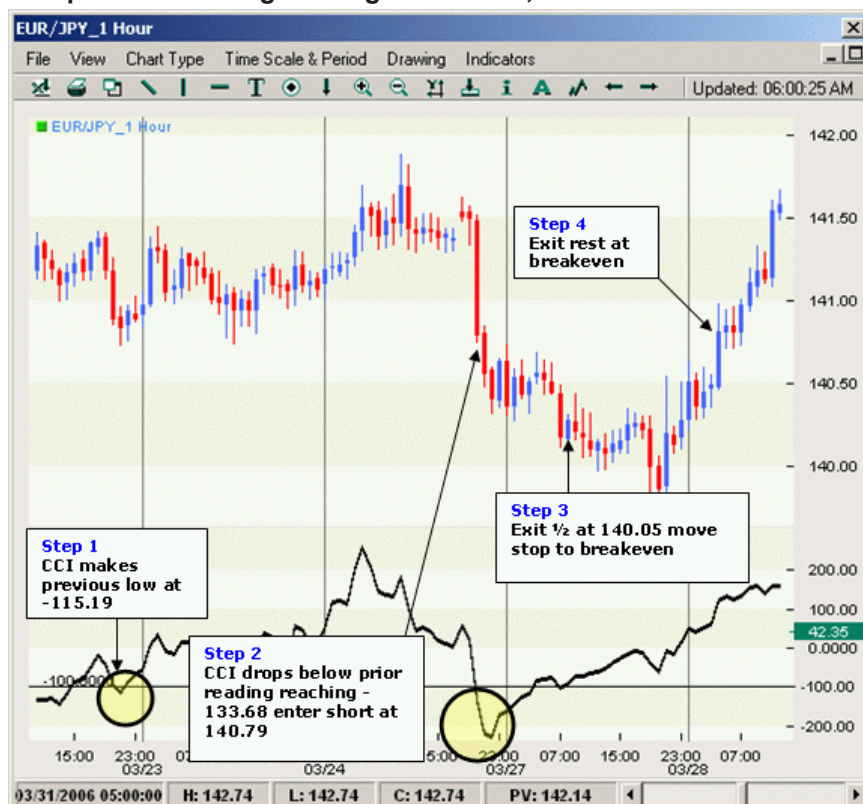


Figure 2 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Here is another example of a short-term trade, this time to the downside in the EUR/JPY.

At 9pm on March 21, 2006, EUR/JPY recorded a reading of -115.19 before recovering above the -100 CCI zone. The “do the right thing” setup triggered almost to the tee five days later at 8pm on March 26, 2006. The CCI value reached a low of -133.68 and we went short on the close of the candle. This was a very large candle on the hourly charts, and we had to risk 74 points as our entry was 140.79 and our stop was at 141.51. The majority of the traders would have been afraid to enter short at that time, thinking that most of the selling had been done. But we had faith in our strategy and followed the setup. Prices then consolidated a bit and trended lower until 1pm on March 27, 2006. Less than 24 hours later we were able to hit our first target, which was a very substantial 74 points. Again we moved our stop to breakeven. The pair proceeded to bottom out and rally, taking us out at breakeven. Although we did not achieve our second target overall, it was a good trade as we banked 74 points without ever really being in a significant drawdown.



## Part 2

### High Probability Trading Setups

#### Setup 2 - “Do the Right Thing” CCI Trade, AUD/USD

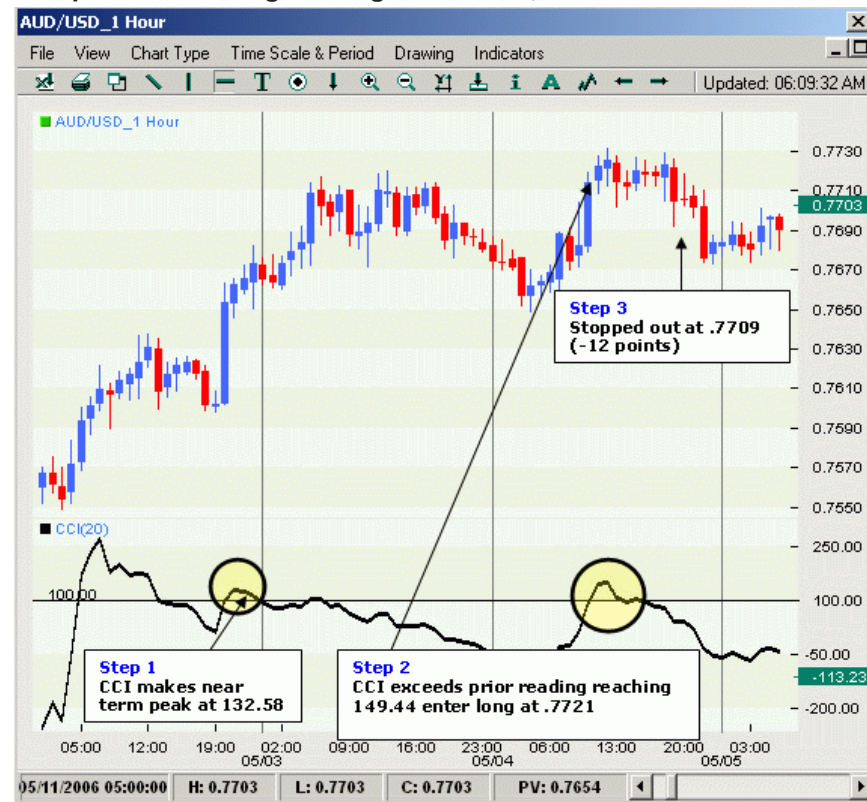


Figure 2 - 2

Source: FXTrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Finally, our last example shows how this setup can go wrong and why it is critical to always use stops. The “do the right thing” setup relies on momentum to generate profits. When the momentum fails to materialize, it signals that a turn may be in the making. Here is how it played out on the hourly charts in AUD/USD. We note that CCI makes a near-term peak at 132.58 at 10pm on May 2, 2006. A few days later at 11am on May 4, 2006, CCI reaches 149.44 prompting a long entry at .7721. The stop is placed at .7709 and is taken out the very same hour. Notice that instead of rallying higher, the pair reversed rapidly. Furthermore, as the downside move gained speed prices reached a low of .7675. A trader who did not take the 12-point stop as prescribed by the setup would have learned a very expensive lesson indeed as his losses could have been magnified by a factor of three. Therefore, the key idea to remember with our “Do the Right Thing” setup is - “I am right or I am out!”

## Part 2

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### High Probability Trading Setups

## 3. Moving Average MACD Combo

In theory, trend trading is easy. All you need to do is “Keep on buying when you see the price rising higher and keep on selling when you see it breaking lower.” In practice, however, it is far more difficult to do successfully. When looking for trend-trading opportunities, many questions arise such as:

*What is the direction of the trend?*

*Should I get in now or wait for a retracement?*

*When does the trend end?*

The greatest fear for trend traders is getting into a trend too late, that is, at the point of exhaustion. Yet despite these difficulties, trend trading is probably one of the most popular styles of trading because when a trend develops, whether on a short-term or long-term basis, it can last for hours, days and even months.

We have developed a strategy that answers all of the questions above while at the same time giving us clear entry and exit levels. This strategy is called the moving average MACD combo. We use two sets of moving averages for the setup: the 50 simple moving average (SMA) and the 100 SMA. The actual time period of the SMA depends upon the chart that you use. This strategy works best on hourly and daily charts. The 50 SMA is the signal line that triggers our trades, while the 100 SMA ensures that we are working in a clear trend environment. The main premise of the strategy is that we buy or sell only when the price crosses the moving averages in the direction of the trend. Although this strategy may seem similar in logic to the “momo” strategy, it is far more patient and uses longer-term moving averages on hourly and daily charts to capture larger profits.

### Rules for a Long Trade

- 1) Wait for the currency to trade above both the 50 SMA and 100 SMA.
- 2) Once the price has broken above the closest SMA by 10 pips or more, enter long if MACD crosses to positive within the last five bars, otherwise wait for the next MACD signal.
- 3) Initial stop set at five-bar low from entry.
- 4) Exit half of the position at two times risk; move stop to breakeven.
- 5) Exit second half when price breaks below 50 SMA by 10 pips.

## Part 2

### High Probability Trading Setups

#### Rules for a Short Trade

- 1) Wait for the currency to trade below both the 50 SMA and 100 SMA.
- 2) Once the price has broken below the closest SMA by 10 pips or more, enter short if MACD crosses to negative within the last five bars; otherwise, wait for next MACD signal.
- 3) Initial stop set at five-bar high from entry.
- 4) Exit half of the position at two times risk, move the stop to breakeven.
- 5) Exit remaining position when the price breaks back above the 50 SMA by 10 pips.

Do not take the trade if the price is simply trading between the 50 SMA and 100 SMA.

Now let's explore some examples:

#### Setup 3 - Moving Average MACD Combo, EUR/USD



Figure 3 - 1

Source: Fxtrik Intellichart, Copyright 2001 - 2005 Fxtrik.com, Inc.

## Part 2

### High Probability Trading Setups



Figure 3 - 1a

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Our first example is for the EUR/USD on an hourly chart. The trade sets up on March 13, 2006, when the price crosses above both the 50-hour SMA and 100-hour SMA. However, we do not enter immediately since MACD crossed to the upside more than five bars ago, and we prefer to wait for the second MACD upside cross to get in. The reason why we have this rule is because we do not want to buy when the momentum has already been to the upside for a while and may therefore exhaust itself. The second trigger occurs a few hours later at 1.1945. We enter the position and place our initial stop at the five-bar low from entry, which is 1.1917. Our first target is two times our risk of 28 pips (1.1945-1.1917), or 56 pips, putting our target at 1.2001. The target gets hit at 11am EST the next day. We then move our stop to breakeven and look to exit the second half of the position when the price trades below the 50-hour SMA by 10 pips. This occurs on March 20, 2006, at 10am EST, at which time the second half of the position is closed at 1.2165 for a total trade profit of 138 pips.



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### High Probability Trading Setups

For those who ask, “Why can’t we just trade the MACD cross from positive to negative?”, you can see just from looking at the EUR/USD chart above that multiple positive and negative oscillations occurred between March 13 and March 15, 2006. However, most of the downside - and even some of the upside signals if taken - would have been stopped out before making any meaningful profits.

On the other hand, for those who ask, “Why can’t we just trade the moving average cross without the MACD?”, take a look at the following chart. If we took the moving average crossover signal to the downside when the MACD was positive, the trade would have turned into a loser.

**Setup 3 - Moving Average MACD Combo, USD/JPY**



Figure 3 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The next example is for USD/JPY on a daily time frame. The trade sets up on September 16, 2005, when the price crosses above both the 50-day and 100-day SMA. We take the signal immediately since the MACD crossed within five bars ago, giving us an entry level of approximately 110.95. We place our initial stop at the five-bar low of 108.98 and our first target at two times risk, which

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### High Probability Trading Setups

comes to 114.89. The price is hit three weeks later on October 13, 2005, at which time we move our stop to breakeven and look to exit the second half of the position when the price trades below the 50-day SMA by 10 pips. This occurs on December 14, 2005 at 117.43, resulting in a total trade profit of 521 pips.

One thing to keep in mind when using daily charts: although the profits can be larger, the risk is also higher. Our stop was close to 200 pips away from our entry. Of course, our profit was 521 pips, which turned out to be more than two times our risk. Furthermore, traders using the daily charts to identify setups need to be far more patient with their trades since the position can remain open for months.

#### Setup 3 - Moving Average MACD Combo, AUD/USD



Figure 3 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

On the short side, we take a look at the AUD/USD on hourly charts back on March 16, 2006. The currency pair first range trades between the 50- and 100-hour SMA. We wait for the price to break below both the 50- and 100-hour moving averages and check to see if MACD at the time went



## Part 2

### High Probability Trading Setups

negative less than five bars ago. We see that it did, so we go short when the price moves 10 pips lower than the closest SMA, which in this case is the 100-hour SMA. Our entry price is 0.7349. We place our initial stop at the highest high of the last five bars or 0.7376. This places our initial risk at 27 pips. Our first target is two times the risk, which comes to 0.7295. The target gets triggered seven hours later, at which time we move our stop on the second half to breakeven and look to exit it when the price trades above the 50-hour SMA by 10 pips. This occurred on March 22, 2006, when the price reached 0.7193, earning us a total of 105 pips on the trade. This is definitely an attractive return given the fact that we only risked 27 pips on the trade.

**Setup 3 - Moving Average MACD Combo, EUR/JPY**



Figure 3 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

From a daily perspective, we take a look at another short example in EUR/JPY. As you can see, the daily examples date further back because once a clear trend has formed, it can last for a very long time. If it didn't, the currency would instead move into a range-bound scenario where the prices simply fluctuate between the two moving averages. On April 25, 2005, we saw EUR/JPY break below the 50-day and 100-day SMA. We check to see that the MACD is also negative, confirming

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### High Probability Trading Setups

that momentum has moved to the downside. We enter into a short position at 10 pips below the closest moving average (100-day SMA) or 137.76. The initial stop is placed at the highest high of the past five bars, which is 140.47. This means that we are risking 271 pips. Our first target is two times risk (542 pips) or 132.34. The first target is hit a little more than a month later on June 2, 2005. At this time, we move our stop on the remaining half to breakeven and look to exit it when the price trades above the 50-day SMA by 10 pips. The moving average is breached to the top side on June 30, 2005, and we exit at 134.21. We exit the rest of the position at that time for a total trade profit of 448 pips.

**Setup 3 - Moving Average MACD Combo, EUR/GBP**



Figure 3 - 5

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Yet this strategy is far from foolproof. As with many trend-trading strategies, they work best on currencies or time frames that trend well. Therefore, it is difficult to implement this strategy on currencies that are typically range bound, like EUR/GBP. The chart above shows an example of the strategy failing. The price breaks below the 50- and 100-hour SMA in EUR/GBP on March 7, 2006, by 10 pips. We check that the MACD is negative at the time, so we get our green light to

## Part 2

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go short 10 pips below the moving average at 0.6840. The stop is placed at the highest high of the past five bars, which is 0.6860. This makes our risk 20 pips, which means that our first take-profit level would be two times the risk, or 0.6800. EUR/GBP continues to sell off but not quite strongly enough to reach our take-profit level. The low in the move before the currency pair eventually reverses back above the 50-hour SMA is 0.6839. The reversal eventually extends to our stop of 0.6860 and we end up losing 20 pips on the trade.

Therefore, traders implementing the moving average MACD strategy should make sure they do so only on currency pairs that are typically very trending. This strategy works particularly well on the majors. Also it might be smart to check the strength of the breakdown below the moving average at the point of entry. If we looked at the average directional index (ADX) at that time, we would have seen that the ADX was very low, indicating that the breakdown probably did not generate enough momentum to continue the move.

## 4. RSI Rollercoaster

Sometimes simplicity is the best of all paths. The relative strength indicator (RSI), invented by Welles Wilder, is one of the oldest as well as one of the most popular tools of technical analysis. In fact, if there was a hall of fame for technical analysis indicators, RSI would certainly be accorded top-five status. Its ability to measure turns in price by measuring turns in momentum is unmatched by almost any other tool in technical analysis. The standard RSI settings of 70 and 30 serve as clear warnings of overbought and oversold territory, and the RSI rollercoaster is a setup that we've developed to take advantage of these turns in the market. The purpose of the RSI rollercoaster is to harvest points from range-bound currency pairs.

First and foremost, this setup works best in a range environment when overbought and oversold readings are far more likely to be true signals of a change in direction. Secondly, as we will see from several examples in this chapter, the setup is much more accurate on the daily charts than on smaller time frames like hourly charts. The primary reason for this difference is that daily charts incorporate far more data points into their subset and, therefore, turns in momentum tend to be more meaningful on longer time frames. Nevertheless, the asymmetrical structure between risk and reward in this setup makes even the shorter time frames worth considering. Just keep in mind that although the setup will fail far more frequently on the shorter-term hourly charts than on the daily ones, the losses will generally be far smaller, keeping the overall risk manageable.

## Part 2

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### High Probability Trading Setups

#### Rules for a Long Trade

1. RSI reading must be less than 30.
2. Wait for an up candle to form and close with an RSI reading greater than 30.
3. Go long at market on the open of the next candle.
4. Place your stop at the swing low.
5. Exit half of the position at 50% of the risk and immediately move the stop on the rest to breakeven.
6. Exit the rest of the position when one or the other following condition is met:
  - a. Stopped at breakeven
  - b. Trade first moves into overbought territory marked by RSI readings of greater than 70 and then eventually drops from that zone. As soon as RSI declines below 70, sell at market on the close of that candle.

#### Rules for a Short Trade

1. RSI reading must be greater than 70.
2. Wait for a down candle to form and close with an RSI reading less than 70.
3. Go short at market on the open of the next candle.
4. Place stop at the the swing high.
5. Exit half of the position at 50% of the risk and immediately move the stop on the rest to breakeven.
6. Exit the rest of the position when one or the other following condition is met:
  - a. Stopped at breakeven
  - b. Trade first moves into oversold territory marked by RSI readings of less than 30 and then eventually rises out of that zone. As soon as RSI increases above 30, buy at market on the close of that candle.

The key to this RSI strategy - versus the traditional interpretation of RSI, which simply trades overbought or oversold levels - is to first look for a reversal candle, which provides us with a sign of exhaustion before taking the trade. This way, we are prevented from prematurely picking a top or bottom and instead wait for indicator confirmation.

Note that the RSI rollercoaster is designed to squeeze as much profit as possible out of the turn trade. Instead of immediately closing out a position when it moves from oversold to overbought condition, the RSI rollercoaster keeps the trader in the market until price shows a sign of exhaustion. Sometimes a strong move will generate multiple consecutive periods of overbought RSI readings, and this setup is specifically intended to catch part of these potentially profitable moves. Note



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### High Probability Trading Setups

also that the RSI rollercoaster is almost always in the market, as the rule for the liquidation of a long trigger is the creation of a fresh short position. The only two times this setup stays out of the market is when the trader is stopped out of his position on a false signal or when he is stopped out at breakeven on the second half of his position.

Now let's take a look at some examples:

#### Setup 4 - RSI Rollercoaster, AUD/JPY



Figure 4 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

In our first example we look at the AUD/JPY currency pair from approximately December 12, 2005 to April 1, 2006. On December 12, the pair records an RSI reading of 73.84, but at the close of the very next candle the RSI drops to 48.13 and we go short at 88.57. Our stop is set at the most immediate swing high of 91.33, or 276 points back. Our first target is set at 50% of our risk, or 138 points forward. The very next day the pair collapses further and our first profit target is realized. We then move our stop to breakeven and stay in the position until RSI reaches oversold territory. On December 27, 2006 RSI moves up from severely oversold readings below 30 to 30.70. We

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### High Probability Trading Setups

exit the second half of the trade at 85.01, harvesting 356 points. Immediately we initiate a long position at the same price as the RSI Rollercoaster has now indicated a buy setup. Our stop is set at the nearest swing low of 84.51. Our risk is a relatively small 50 points and thus our first profit target is a very modest 25 points, which we achieve in the very next candle when prices rise to 85.26. We move our stop to breakeven and stay in the trade for more than a month until February 6, 2006 when RSI leaves the overbought territory and we liquidate the rest of our position at 88.23 for a 322-point profit. Again we immediately sell at the same price to establish a new short, as per the setup. The swing high of 89.34 serves as our stop. The first target of 87.68 is achieved the very next day as we bank 55 points. We exit the rest of the position at 84.01 when RSI once again returns from its oversold level. The second half of the position produces a 422-point gain. All in all, the RSI Rollercoaster generates a very respectable 660 points (1319/2) over a four-month time frame.

Some traders may not have enough patience to trade the RSI rollercoaster on daily charts, so the next example of the setup is on four-hour charts.



## Part 2

### High Probability Trading Setups

#### Setup 4 - RSI Rollercoaster, EUR/USD



Figure 4 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

In the four-hour chart of the EUR/USD shown on the previous page, we see the RSI rollercoaster perform well once again. We start on March 21, 2006, as RSI, after spending some time in the overbought zone above 70, finally falls below that value, triggering a short order at market at 1.2178. The swing-high stop is extremely close at 1.2208, allowing us to risk only 30 points on the trade. Our first target at 1.2163 is hit within the next candle and we move the stop to breakeven and follow the trade. The pair eventually trades down to 1.2035 before regaining upside momentum, and we are able to close out the second half of the position with an additional 138-point profit. We then immediately go long at the same price. This time our risk is considerably larger at 100 points, as the swing low lies at 1.1935. Nevertheless, the pair climbs steadily and we reach our first target with ease, exiting at 1.2085 for a 50-point gain. We then stay in the trade until the rules of the setup force us to liquidate at breakeven. All in all, in this example of the RSI rollercoaster we are able to harvest a total of 203 points while risking only 260 points. Although in this sequence the risk reward ratio is a bit less than 1:1 the high probability aspect of this setup generally assures positive expectancy overall.

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#### Setup 4 - RSI Rollercoaster, USD/CHF



Figure 4 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Turning now to the one-hour time frame, we see that the RSI Rollercoaster performs far worse on the shorter time frame. Starting on April 3, 2006, the setup triggers a short at 1.3090 with a 35-point stop at the swing high of 1.3125. The trade moves our way almost instantly, and we are able to quickly cover half the position for 17-point profit. Again we move our stop to breakeven and stay in the trade all the way to 1.2902, harvesting 197 points in the process. However, before we celebrate too quickly, the setup triggers an immediate long trade and generates three consecutive stop outs as the RSI peeks above the 30 level only to retreat into oversold territory once again. Overall, we lose -28, -36 and -47 points times two lots. Cumulative loss? Minus 222 points. The three losses fully negate our one big win, and we actually stand at the end of the run down eight points. To add insult to injury, when the pair does make a turn to the upside we miss the entry because the rally starts from RSI values above 30 and our setup does not trigger a signal.

What to do about this? One solution is to simply not trade the RSI rollercoaster on time frames less than four hours in length. This setup is designed to catch major turns in price action and

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### High Probability Trading Setups

works best in range-bound markets that consistently move from overbought to oversold states. The hourly charts are simply too sensitive for the indicator, generating many false-turn signals as prices simply pause rather than change direction. On the hourly charts it is far easier for RSI to work off the temporary overbought/oversold conditions without making a true turn. Nevertheless, the setup may still be productive for shorter-term-based traders if we add some modifications. The key to making the RSI rollercoaster successful on the hourly or shorter time frames is to never assume greater than 30-point risk on any trade. In fact 30 points of risk should be the maximum that the trader should be willing to absorb on any one given trade. Ideally, the risk on any hourly version of RSI Rollercoaster should be no more than 15 points. This change will, of course, force traders to pass up many setups, but on the flip side they would be able to sustain three or even four consecutive losses in a row with only minimal damage to their equity; and only one good trade of 100 points or more would put the account right back into positive territory. On the hourly time frames the signal-to-noise ratio will inevitably increase, therefore, it is vital to minimize the many likely losses in order to maintain a positive expectancy in the setup.

## Part 2

### High Probability Trading Setups

#### Setup 4 - RSI Rollercoaster, GBP/USD



Figure 4 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Finally, let's take a look at the RSI rollercoaster on the GBP/USD hourly charts during the period from March 27, 2006 to March 29, 2006. We will follow the exact same rules as outlined above, with one modification: If our risk exceeds 35 points, we will not take the trade. On March 27 at 1am, we trigger a short sell at 1.7458, risking 24 points. The trade goes against us, and we get stopped out as the pair works off the overbought condition and trades higher. Later in the day we get a second signal and once again go short at 1.7477. Our risk is a miniscule 10 points. We set our target at 50% of risk and cover the first part of the trade at 1.7472, moving the stop to breakeven. Once again the trade moves away from us, but we cover at our entry point, and for all intents and purposes, the trade turns into a scratch instead of another loser. Finally, at about midday on March 28, we get a third signal to short at 1.7504. This time the risk is a more considerable 32 points, but it is just within our self-imposed risk-control rule of 35 points. We cover half the position at 1.7488, garnering 16 points, and then follow the trade all the way down to 1.7315, harvesting a very impressive 189 points on the second half of the trade. The total gain from this three-day foray into trading the pound is 162 points, but note that the vast bulk of the profits were netted from the



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### High Probability Trading Setups

final half position of the third trade. In fact, that 189-point move was responsible for more than 90% of all the trading gains of the setup. The rest of the time we lost small or essentially broke even. That in fact is the basic dynamic of the RSI rollercoaster setup, especially on shorter time frames. It is a low-probability/high-reward setup, and as such requires the trader to follow two key rules: 1) He must take as many trades as his risk-control rules will allow to optimize his chance of catching the one big win; and 2) He must also take very small highly defined risks while waiting patiently for the big-profit trade. As you can see, in RSI rollercoaster half the value of the strategy comes from the rules themselves, while the other equally important half is derived from a strict money management approach.

## 5. Pure Fade

Everyone wants to be the hero and claim that he or she picked the very top or bottom of a currency pair. However, aside from bragging rights, is there really anything that pleasant about repetitively selling at every new high in hopes that this one would finally be the top? The answer is a resounding “no”! One of the biggest pitfalls encountered by novice traders is arbitrarily picking a top or bottom with no indicator support. The pure fade trade is an intraday strategy that picks a top or bottom based upon a clear recovery following an extreme move.

The strategy looks for an intraday reversal by using a combination of three sets of Bollinger bands and the relative strength index on hourly charts. The trade sets up when the RSI hits either an overbought or oversold level. Overbought is defined as RSI above 70, while oversold is defined as RSI below 30. This signals to us that we can start looking for a possible reversal. However, rather than just immediately buying in hopes for a trend reversal based solely upon RSI, we add in three sets of Bollinger bands to help us identify the point of exhaustion. The reason why we use three sets of Bollinger bands is because it helps us to gauge the extremity of the move along with the extent of the possible recovery.

Created in the 1980s by John Bollinger, the originally developed Bollinger bands strategy was based upon two standard deviations (SD) above and below the 20-day moving average. The theory was then to buy or sell when the prices hit the Bollinger band because using two standard deviations ensures that 95% of the price action will fall between the two bands. In our strategy, we add on the third standard deviation Bollinger band. When prices hit the third band on any side, we know that the move is within the 5% minority, which then characterizes the move as extreme. When we move away from the third standard deviation Bollinger band and into the zone between the first and second standard deviation Bollinger bands, we know that the currency pair has hit its extreme point at the moment and is moving into reversal phase. Finally, one last thing that we look for is at least one candle to close fully between the second and first standard deviation bands. This last rule

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### High Probability Trading Setups

helps to screen out fake moves and makes sure that the previous move is really an exhaustion. This is a low-risk, low-return trade for those who simply want to scalp the market for small profits.

We recommend using only hourly charts with the following rules:

#### **Rules for a Long Trade**

- 1) Look for the relative strength index to be lower than 30.
- 2) Watch for the price to hit the three standard deviation Bollinger band (SD BB).
- 3) Wait for the candle to move from the 3SD-2SD BB zone into the 2SD-1SD BB zone on hourly charts.
- 4) After one candle closes fully within the 2SD-1SD BB zone, buy at market.
- 5) Place stop at swing low minus 10 pips.
- 6) First target for half of the position is the amount risked; move stop to breakeven.
- 7) Second target is tag of the second SD BB on the top side.

#### **Rules for a Short Trade**

- 1) Look for the relative strength index to be greater than 70.
- 2) Watch for the price to hit the three standard deviation Bollinger band (SD BB).
- 3) Wait for the candle to move from the 3SD-2SD BB zone into the 2SD-1SD BB zone on hourly charts.
- 4) After one candle closes fully within the 2SD-1SD BB zone, sell at market.
- 5) Place stop at swing high plus 10 pips.
- 6) First target for half of the position is the amount risked; move stop to breakeven.
- 7) Second target is tag of the second SD BB on the down side.



## Part 2

### High Probability Trading Setups

Now let's explore some examples:

#### Setup 5 - Pure Fade, EUR/USD



Figure 5 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The first example is the EUR/USD from February 22, 2006. The currency pair started breaking down shortly after the London open and hit our radar screen when we saw RSI dip below 30, around 6am EST. We checked the Bollinger bands and saw that the price also hit our third standard deviation band at that time and is now trading between the third and second standard deviation Bollinger bands. We watch closely for a full close within the second and first standard deviation Bollinger bands, at which time we buy at market.

Our trade gets triggered at 9am EST, and we enter into a long position at 1.1884. We immediately place our stop at the swing low, which is 1.1862, risking 22 pips on the trade. Since our first take profit is the amount that we risked, we put in an order to sell half of the position at 1.1906. The order gets triggered four hours later at 1pm EST. We move our stop to breakeven and get ready to sell the second half when the price hits the second standard deviation Bollinger band on the

## Part 2

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topside. The remainder of the position is eventually closed out at 1.1939 for a total trade profit of 38 pips.

#### Setup 5 - Pure Fade, NZD/USD



Figure 5 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The next example is the NZD/USD on February 26, 2006. Like the EUR/USD in the previous example, the currency pair range traded going into the open of the Asian markets when New Zealand economic data is typically released. Our pure fade trade sets up when we see RSI dip below 30 at 6pm EST. We check to see that the price has also hit our third standard deviation Bollinger band at that time. We then watch carefully for a full bar close between the second and first standard deviation Bollinger bands. This happens at 9pm EST, at which time we go long at the open of the next bar, or at 0.6583. We place our stop at the swing low of 0.6568, risking a total of 15 pips on the trade. The risk is very small, which puts our profit at a very achievable 0.6598. This level is reached at 8am EST the next day, at which time we move our stop to breakeven and target the second deviation Bollinger band on the top side for the remainder of our position. The band is hit and we exit at 0.6605, for a total trade profit of 18.5 pips.

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#### Setup 5 - Pure Fade, USD/JPY

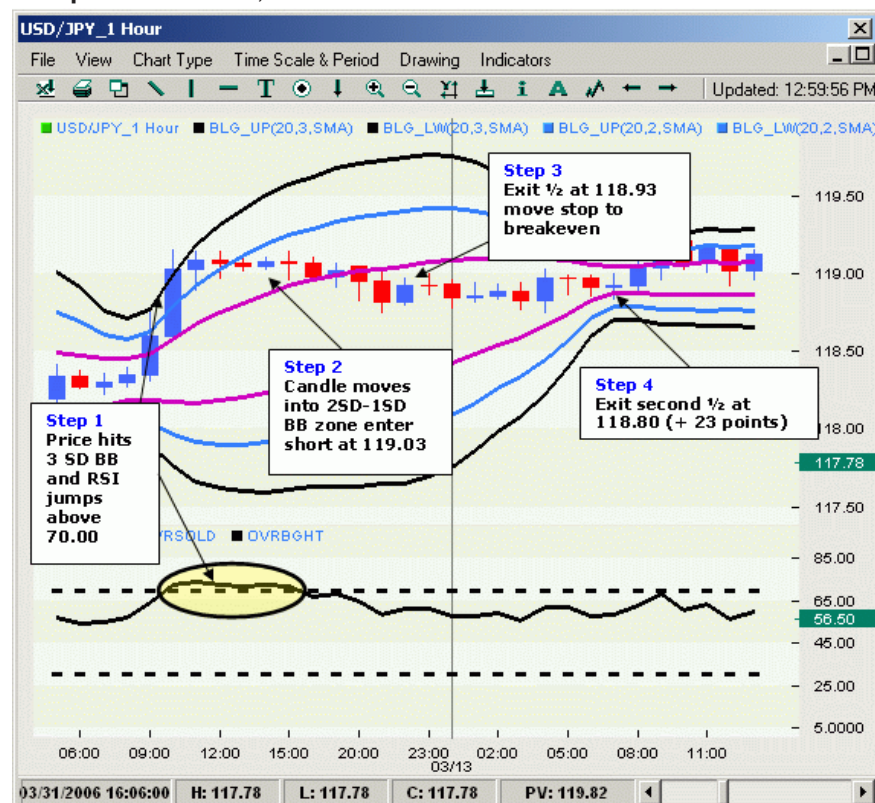


Figure 5 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

On the short side, we look at an example in USD/JPY from March 10, 2006. Going into the open of the U.S. markets, we watched USD/JPY trade quietly in a tight range. Shortly after the typical 8:30am EST U.S. numbers, the currency pair hits our radar screens when RSI breaks above 70, the benchmark for overbought conditions. At the same time, the price hits the third standard deviation Bollinger band and we watch for a full close between the second and first standard deviation bands. This happens three hours later, and we enter a short USD/JPY position at 119.03. Our stop is the swing high of 119.13, putting our risk at a tiny 10 pips. Our first target is therefore 118.93, which gets triggered at 3pm EST. Once our target is hit, we move our stop on the remainder of the position to breakeven and look to take profit once we hit the second Bollinger band on the downside. At 4am EST the following day, we exit the remainder of our position at 118.80 for a total trade profit of 16.5 pips, before the position reverses course and begins rallying once again. As you can see, the pure fade trade takes small profits quickly in times of trend exhaustion. However, more often than not, the trend continues course after prices hit the second Bollinger band in the opposite

## Part 2

### High Probability Trading Setups

direction.

#### Setup 5 - Pure Fade, GBP/USD



Figure 5 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The GBP/USD chart above is another good example of a short fade trade. On March 16, 2006, we watch the GBP/USD trade in a tight range going into the release of February U.S. consumer prices. The dollar begins to sell-off shortly after 8:30am EST, after the softer-than-expected report and continues to push the GBP/USD higher for the next seven hours. The currency pair hits our radar screen at noon EST when RSI breaks above 70. We check to see that the price is also tagging the third standard deviation Bollinger band on the top side, so we begin to look for an opportunity to go short the GBP/USD when we see a full bar close below the third and second standard deviation Bollinger band zone. This occurs at 4pm EST at which time we go short at the open of following bar, or 1.7569. We place our stop at the swing high of 1.7594, which means that we are risking 25 pips. The target for the first half of our position is our entry minus the amount that we risked, or 1.7544. After we entered into our position, the GBP/USD begins to gradually sell-off, triggering our take profit order at 10pm EST. We then look to exit the remainder of the position when the



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### High Probability Trading Setups

price hits the first standard deviation Bollinger band on the opposite side. This occurs the following day, giving us an exit of 1.7527 and earning us a total of 33.5 pips on the entire trade. At this point, some traders looking at the charts may say, “Oh wow, the second half was triggered at 3am EST, I’m asleep!” It is very likely that you may not be able to spend the entire wee hours with your eyes glued to the computer screen, so for those who just want a target to place the second take profit order, two times the amount risk would be a good level. In this case, we could have placed our second exit order at 1.7519.

#### Setup 5 - Pure Fade, GBP/JPY



Figure 5 - 5

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Of course, no one strategy can be accurate 100% of the time, so the last example is one where the trade did not end up in a profit. The GBP/JPY chart above is from February 14, 2006. At 7pm EST, or at the Asian market open, GBP/JPY begins to break out of its post-U.S./pre-Asian price consolidation. RSI breaches the 30 oversold mark, and the price hits the third standard deviation Bollinger band, which puts the currency on our radar screen, where we look for an opportunity to go long. We wait four hours later and see a candle open and close fully within the first and second

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### High Probability Trading Setups

standard deviation Bollinger bands, so we look to buy at the open of the next candle. Our entry price is 204.52. We put our stop at the swing low, or 204.34, which means that we are risking a total of 18 pips. Following our rules of taking profit on the first half of our position by the amount risked, we put an entry order to sell half at 204.70. GBP/JPY, however, was unable to sustain its momentary relief rally and proceeded to extend its weakness. We were stopped out at 204.34 two hours later, but since the risk was small, the loss should have had a minimal impact on most trading accounts.

## 6. The Memory of Price

Is there anything more annoying than getting stopped out of a short trade on the absolute top tick of the move or being taken out of a long trade on the lowest-possible bottom tick, only to have prices reverse and then ultimately move in your direction for profit? Anyone who has ever traded currencies has experienced that unpleasant reality more than once. We designed this setup specifically to take advantage of these spike moves in currencies by carefully scaling into the trade in anticipation of a reversal.

The memory of price should appeal to traders who despise taking frequent stops outs and like to bank consistent, albeit small, profits. However, anyone who trades this setup must understand that while it misses infrequently, when it does, the losses can be very large. Therefore, it is absolutely critical to honor the stops in this setup, because when it fails it can morph into a relentless runaway move that could blow up your entire account if you continue to fade it.

This setup rests on the assumption that support and resistance points of double tops and double bottoms exert an influence on price action even after they are broken. In effect, they act almost like magnetic fields attracting price action back to those points after the majority of the stops have been cleared. The thesis behind this setup is that it takes an enormous amount of buying power to exceed the value of the prior range of the double-top breakout and vice versa for the double-bottom breakdown. In the case of a double top, for example, breaking above a previous top requires that buyers not only expend capital and power to overcome the topside resistance but retain enough additional momentum to fuel the rally further. By that time, much of the momentum has been expended on the challenge to the double top, and it is unlikely that we will see a move of the same amplitude as the one that created the first top.

How do we determine risk in this setup? We use a symmetrical approach. Using our double-top example, we measure the amplitude of the retrace in the double top and then add that value to the swing high to create our zone of resistance. Figure 1 shows exactly what we mean.



## Part 2

### High Probability Trading Setups

#### Setup 6 - The Memory of Price, EUR/USD



Figure 6 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Note how price does push higher above the initial swing high of 1.2060 but cannot quite extend the up move by the full amplitude of the initial retracement. We see this happen quite often on both the hourly charts as well as daily charts. On the dailies, the setup will suffer fewer failures (mainly because the range extensions will be much larger); but on the other hand, it will generate much larger losses. Therefore, traders must weigh the advantages and disadvantages of each approach and adapt their risk parameters accordingly.

#### Rules for the Short Trade

1. Look for an established uptrend that is making consistently higher lows.
2. On the daily or the hourly charts note when this up-move makes a retrace.
3. Make sure that this retrace is at least 38.2% of the original move.
4. Enter short half the position (position No.1) when price rallies to the swing high making

## Part 2

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### High Probability Trading Setups

a double top.

5. Measure the amplitude of the retrace segment.
6. Add the value of the amplitude to the swing high and make that your ultimate stop.
7. Target 50% of the retrace segment as your profit (i.e., if retrace segment is 100 points, target 50 point as your profit).
8. If position moves against you, add the second half of the position (position No.2) at the 50%-point between the swing high and the ultimate stop.
9. Keep the stop on both units at the ultimate stop value.
10. If position #2 moves back to the entry price of position No.1, take profit on position No.2; move stop to breakeven and continue holding position No.1 for initial target.

#### Rules for the Long Trade

1. Look for an established downtrend that is making consistently lower highs.
2. On the daily or the hourly charts note when this down-move makes a retrace.
3. Make sure that this retrace is at least 38.2% of the original move.
4. Enter long half the position (position No.1) when price falls to the swing low making a double bottom.
5. Measure the amplitude of the retrace segment.
6. Add the value of the amplitude to the swing low and make that your ultimate stop.
7. Target 50% of the retrace segment as your profit (i.e., if retrace segment is 100 points, target 50 point as your profit).
8. If position moves against you, add the second half of the position (position No.2) at the 50%-point between the swing low and the ultimate stop.
9. Keep the stop on both units at the ultimate stop value.
10. If position No.2 moves back to the entry price of position No.1, take profit on position No.2; move stop to breakeven and continue holding position No.1 for initial target.

## Part 2

### High Probability Trading Setups

Now let's see how this setup works on both the long and short time frames.

#### Setup 6 - The Memory of Price, GBP/USD



Figure 6 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

First let's look at a long setup in GBP/USD, which begins to form on November 12, 2005. Notice that prices first rally but then begin to drop, setting up for a possible double bottom. In accordance with the rules of our setup, we take half our position at 1.7386, expecting prices to bounce back up. When this setup is traded on the daily charts, the stops can be enormous. In the case of this long setup the stop is more than 500 points large (the amplitude of the counter-move up is  $1.7907 - 1.7386 = 521$  points). Yet it will soon become clear why such a wide stop is necessary. On a hypothetical \$10,000 account, the trader should never trade more than two mini-lots (10,000 units where 1 point move is worth \$1). This will already violate our "no-more-than-2%-risk-per-trade" rule, as the total drawdown would exceed 7.5% if the setup failed ( $521 \text{ points} + 260 \text{ points} = \$780$  or 7.8% on a \$10,000 account). You can compensate for this risk by toning down the leverage if you are trading the memory of price strategy however the high probability nature of the setup allows us to be more liberal with risk control. Nevertheless, the bottom line is that on the dailies leverage

## Part 2

### High Probability Trading Setups

should be extremely conservative not exceeding a factor of two meaning that for a hypothetical \$10,000 account the trader should not assume a position larger than \$20,000 in size,...

As the trade proceeds, we see that the support at 1.7386 fails; we therefore place a second buy order at 1.7126 - halfway below our ultimate stop of 1.6865. We now have a full position on and wait for market action to respond. Sure enough, having expended so much effort on the downside move, prices begin to stall way ahead of our ultimate stop. As the price bounces back, we sell the one lot, which we purchased at 1.7126, back at 1.7386 - our initial entry point in the trade, banking 260 points for our efforts. We then immediately move our stop on the remaining lot to 1.7126, ensuring that the trade will lose us no capital should the price fail to rally to our second profit target. However on November 23, 2005, the price does reach our second target of 1.7646, generating a gain of another 260 points for a total profit on the trade of 521 points. Therefore, what would wind up as a loss under most standard setups (since support was broken by a material amount), actually turns into a profitable high probability trade.

**Setup 6 - The Memory of Price, GBP/USD**

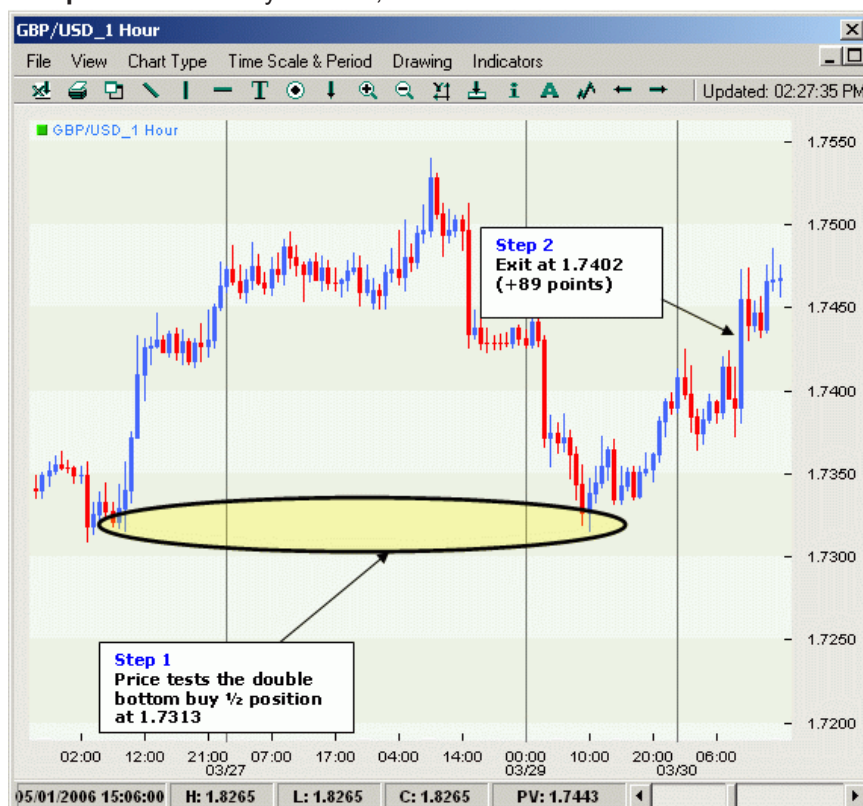


Figure 6 - 3

Source: FXTrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

## Part 2

### High Probability Trading Setups

Now let's take a look at the setup on a shorter time frame using the hourly charts. In this example, the GBP/USD traces out a countertrend move of 177 points that lasts from 1.7313 to 1.7490. The move starts at approximately 9am on March 29, 2006, and lasts until 2pm the following day. As the price trades back down to 1.7313, we place a buy order and set our stop 177 points lower at 1.7136. In this case, the price does not retreat much further, leaving us with only the first half of the position as it creates a very shallow fake out double bottom. We take our profits at 50% of risk, exiting at 1.7402 at 8pm on April 3, 2006. The trade lasted approximately four days, with very little drawdown, and produced a healthy profit in the process. Note also that on the shorter time frames the risk of this setup was considerably less than the daily version with the ultimate stop only 177 points away from entry, versus the prior example where the stops were fully 521 points away.

#### Setup 6 - The Memory of Price, EUR/USD



Figure 6 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Turning now to the short side, we look at the daily chart in the EUR/USD trading a relatively small retrace at the beginning of 2006 from 1.2181 to 1.2004. As price once again approaches the 1.2181 level on January 23, 2006, we go short with half of total position, placing a stop at 1.2358. Prices



## Part 2

### High Probability Trading Setups

then verticalize, and at this point the strategy of the setup really comes into play as we short the second half at 1.2278. Prices push higher - beyond even our second entry - but the move exhausts before hitting our stop. We exit half of the trade as prices come back to 1.2181 and move our stop to breakeven on the whole position. Prices then proceed to collapse even further as we cover the second half at 1.2092, banking the full profit on the trade.

#### Setup 6 - The Memory of Price, USD/JPY



Figure 6 - 5

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

In another short example of this setup, we look at the hourly chart in the USD/JPY as it forms a retrace between 8am March 29, 2006 and 8am March 30, 2006. The amplitude of that range is 118.22 to 117.08, or 116 points. We then add 116 points to the swing high of 118.22 to establish our ultimate stop of 119.36. As price trades back up to 118.22 on April 3, 2006, we short half of our position size and then short the rest of the position at 118.78. Prices do not trade much higher, and by 10am the next day we are able to cover half of our short at 118.22. Just 10 hours later, at 8pm, we are able close out the rest of the position at full profit.

## Part 2

### High Probability Trading Setups

This example illustrates once again the power of this setup on the shorter time frames. Note again how the small risk parameters and the relatively short time frames allow nimble FX traders to take advantage of the natural daily ebb and flow of the markets. Clearly this setup works best in range-bound markets, which occur a majority of the time. Now, however, let's look at an example of when this setup fails.

**Setup 6 - The Memory of Price, USD/JPY**



Figure 6 - 6

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The gravest danger to the memory of price setup is a one-way market during which prices simply do not retrace. This is the reason why keeping disciplined stops is so essential to this strategy, as just one runaway trade could blow up the trader's entire portfolio. In the preceding example we see how the daily trend on the USD/JPY pair during the fourth quarter of 2006 reached such powerful momentum that traders had no chance to recoup their losses with shorts simply steamrolled. Starting with the initial entry on September 20, 2005 off the countertrend move at 111.78, we would have proceeded to short the pair at half position value, adding yet another half position seven days later on September 27, 2005 at 113.33. Unfortunately, prices did not pause in their ascent, and the whole

## Part 2

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### High Probability Trading Setups

trade was stopped out at 114.88 on October 13, 2005, for a total loss of 465 points  
 $(114.88 - 111.78) + (114.88 - 113.33) = 465$

#### A Variation on the Theme

One of the concerns some traders have with the memory of price is its asymmetrical risk-reward nature. Those readers quick with their math skills probably noticed that under the best of circumstance, the setup harvests one unit of reward for every 1.5 units of risk. In the prior trade, for example, the total loss incurred on the position was equal to -465 points; but if it worked out to plan, the reward would have only resulted in a 310-point gain. The memory of price works because it is typically a high probability setup. Indeed, it would have to be accurate 70% of the time in order to have positive expectancy in the long run.

However, traders uncomfortable with the negative risk-reward ratios may consider a variation on the theme. This version of the strategy does not offer as many opportunities for trades and may be less accurate, but its risk-reward ratios are more in sync with conventional trading, and it follows only a single price-entry rule rather than a scale-in approach.

Here are the rules for this version of the memory of price:

#### Rules for the Long Trade

1. On the daily or the hourly charts note a retrace of a down move.
2. Measure the amplitude of the retrace, which should be at least 38.2% of the original move.
3. Add the value of the amplitude to the swing low and make that your ultimate stop.
4. Enter long the full position (two units) when price falls one-third of the way below the swing low.
5. Target 50% of the retrace segment as your profit No.1 (i.e., if retrace segment is 100 points, target 50 point as your profit No.1).
6. Move stop to breakeven.
7. Target 100% of the retrace segment as your profit No.2 (i.e., if retrace segment is 100 points, target 100 points as your profit No.2).

#### Rules for the Short Trade

1. On the daily or the hourly charts note a retrace of an up move.
2. Measure the amplitude of the retrace, which should be at least 38.2% of the original move.

## Part 2

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### High Probability Trading Setups

3. Add the value of the amplitude to the swing high and make that your ultimate stop.
4. Enter short the full position (two units) when price rises one-third of the way above the swing high.
5. Target 50% of the retrace segment as your profit No.1 (i.e., if retrace segment is 100 points, target 50 point as your profit No.1).
6. Move stop to breakeven.
7. Target 100% of the retrace segment as your profit No.2 (i.e., if retrace segment is 100 points, target 100 points as your profit No.2).

The advantage of this strategy is that it has a slightly positive risk-reward skew of about 1.15:1. To fully understand why, simply use a 100-point segment to calculate the ratios. A trader with a 100-point stop above the swing high would enter at about 33 points above such high or approximately, one-third of the way up. (Those traders who like Fibonacci numbers may prefer to enter at 38.2% above the swing high, but for matters of simplicity we chose one-third as target entry). That means that the risk on a 100-point segment is approximately 134 points  $(100-33)*2$  units. The reward on this strategy is about 150 points. Target No.1 is 50 points, and target No.2 is 100 points.  $150/134$  is approximately a 1.15:1 risk-reward ratio, which means that at even 50% accuracy this setup has a positive expectancy.

## Part 2

### High Probability Trading Setups

Now let's take a look at how this setup works under real price conditions.

#### Setup 6 - The Memory of Price, EUR/USD

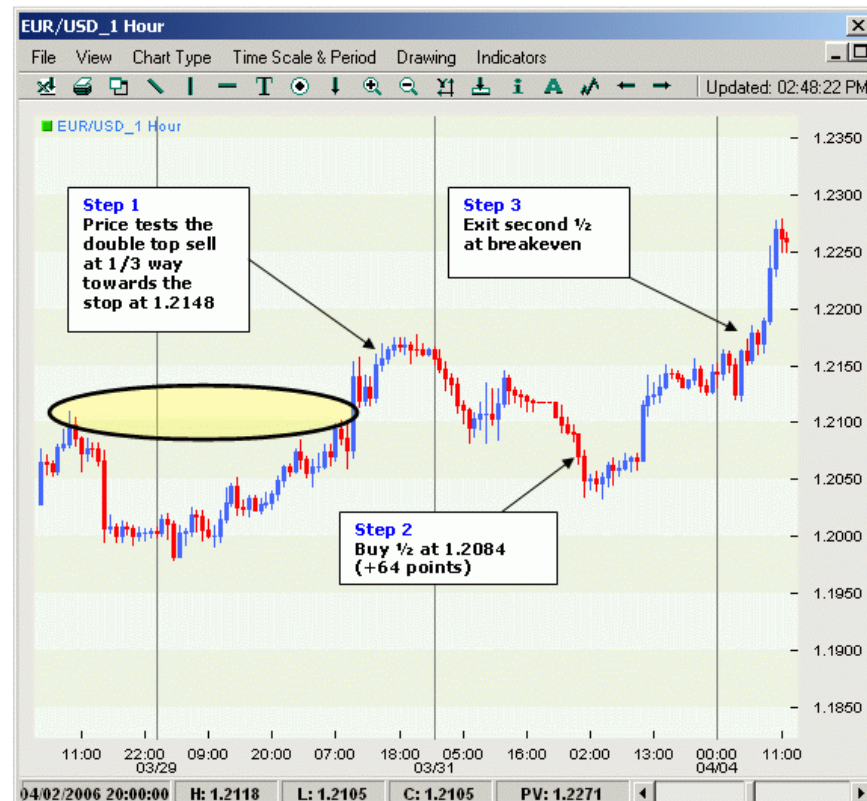


Figure 6 - 7

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

On March 29, 2006, we mark a retrace segment in the EUR/USD that extends from 1.2105 to 1.1979, or 126 points. As the pair breaks to the upside, we short one-third of the way through at 1.2148 at 10am on March 30, 2006. The trade moves slightly against us but then starts its turn, and at 1am on April 3, 2006, it reaches our first target of 1.2084. We move our stop to breakeven as soon as the first target is hit and then stay in the trade. In this case the trade reaches our first target but stops us out at breakeven point on the second half of the position, which is in line with our strategy of never letting a winner turn into a loser.



## Part 2

### High Probability Trading Setups

#### Setup 6 - The Memory of Price, GBP/USD



Figure 6 - 8

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Finally, here is an example of a long trade using the same idea. On March 3, 2006 we see a strong countertrend segment in the GBP/USD that runs for 169 points from 1.7314 to 1.7482. We enter a buy order at 1.7258 one-third of the way down with our stop resting at 1.7314 minus 169 points, or 1.7145. The trade barely moves against us after we enter in our long position, and we then watch as the price continues to rally, letting us take profit on the first half of our position - at 1.7342 on April 3, 2006 - and then take profit on the rest of the position at 1.7426, for a total gain of 252 points.

## 7. Seven-Day Extension Fade

Being from New York, we tend to doubt and question everything. If a stranger walks past us on the way to subway and says “hello”, we are bewildered and immediately wonder if he is a tourist. Though greeting strangers is far more common in smaller towns, the skeptical personality trait can be found in many traders, regardless of where they live. As mentioned in our pure fade strategy, trying to pick tops or bottoms is one of the most popular tactics employed by individual traders. However, we also said doing so with no indicator support is probably one of the least constructive ways of trading. Yet, proving our own contrarian nature, we are about to unveil a strategy that does indeed pick a top or bottom with no indicator support. This strategy is called the seven-day extension fade.

Taking a step back, we know that indicators are essentially mathematical representations of prices, calculated from many different perspectives. Therefore, why not just look at the prices themselves? The seven-day extension fade is based on the premise that after seven days of consecutive strength, a currency pair’s move is due for a retracement. Why seven days? This number is drawn from our observation of daily market activity. Oftentimes, at the beginning of a week, a new trend will emerge. If the trend is strong enough, it can last for several days with virtually no retracement.

However, after seven days of consecutive strength (which encompasses almost a week and a half of uninterrupted directional movement), prices need to pause. Generally, people tend to think in groups of sevens. It is well documented that many psychologists believe most human beings have the best retention rates on numbers that are in groups of seven or less. This is part of the reason why phone numbers here in the U.S. only have seven digits, aside from the area code of course. Although five or six days of exhaustion do work - and we have seen reversals occur after those periods as well - the seven-day reversal pattern is more accurate. We have occasionally seen moves that last for eight days, but those instances are very rare. This is where discretion can be used effectively. If the fifth or sixth day of exhaustion coincides with a key technical level, then the move may very well stall at that point. However, by following our rule of looking for only the highest probability trades, we prefer to use the seven-day period method. Even though the setup is rare, when it does occur, it is significant. We have tried this strategy on hourly charts, but since sentiment tends to be much more intractable in the market throughout the day, the setup is not nearly as reliable. We have seen trends last eight hours before reversing many times, while we rarely see trends last eight days with any retracements on daily charts. Finally, a very important condition of this setup is that every candle in an uptrend must be positive, and every candle in a downtrend must be negative. If the sequence of seven candles is interrupted by a neutral candle (a candle where the close = open), then the count must start from scratch.

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### High Probability Trading Setups

The rules for this strategy are fairly simple since it is based solely on price and candlesticks. The accuracy of the strategy increases when the seventh candle coincides with a key technical level.

Use daily charts:

#### **Rules for a Long Trade**

- 1) Look for seven consecutive bars of weakness (where each bar's close is below the prior).
- 2) Buy at the open of the next bar.
- 3) Place stop at the low of the seventh bar minus 10 pips.
- 4) First target is amount risked; move stop on remaining half to breakeven.
- 5) Second target is three times the amount risked.

#### **Rules for a Short Trade**

- 1) Look for seven consecutive bars of strength (where each bar's close is above the prior).
- 2) Sell at the open of the next bar.
- 3) Place stop at the high of the seventh bar plus 10 pips.
- 4) First target is amount risked; move stop on remaining half to breakeven.
- 5) Second target is three times amount risked.

## Part 2

### High Probability Trading Setups

Now let's explore some examples:

#### Setup 7 - Seven-Day Extension Fade, NZD/USD



Figure 7 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The first example is a daily chart of the NZD/USD. We see that the currency pair begins its downtrend on December 15, 2005, which lasts for exactly seven days. We enter at the open of the candle on the eighth day, placing our entry price at 0.6723. We place our stop at 0.6690, which is 10 pips below the previous candle's low of 0.6700. This means that we are risking 33 pips on the entire trade. We immediately place our first target exit order at entry plus the amount risked, or 0.6756. The reversal occurs on the second day, and our exit order is triggered. We then move our stop to breakeven and place our second take-profit order at three times the amount risked, or 0.6822. This order gets triggered five days later, allowing us to capture 66 pips on the trade for a nice 2:1 risk-reward ratio.

## Part 2

### High Probability Trading Setups

#### Setup 7 - Seven-Day Extension Fade, EUR/USD



Figure 7 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The next example is the same strategy on a shorter time frame chart for the EUR/USD. We see the EUR/USD begin to sell off on April 2, 2006, at 7pm EST, pretty much right at the Asian market open. The sell-off deepens and continues for seven consecutive hours, or almost one entire trading session. After the close of the seventh hour, we place an order to buy at the open, or 1.2047. Our stop is placed at 1.2222, which is 10 pips below the low of the prior candle. Our first target is our entry price plus the 25 pips of risk, which then equates to 1.2072. Our second target is 1.2122, which is the entry price plus three times the amount risked, or 75 pips. Both targets are hit between the European and U.S. trading sessions, earning us a total of 50 pips on the entire trade.

Finding examples on the short side, especially on the shorter time frame, is generally easier than finding examples on the long side. Most sell-offs tend to last closer to five or six days instead of seven. This could be due to the fact that most traders, having primarily come from the stock market, are more ingrained to buy than sell because of the market's age-old uptick rule.



## Part 2

### High Probability Trading Setups

#### Setup 7 - Seven-Day Extension Fade, USD/CHF



Figure 7 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The first example on the short side is a daily chart of USD/CHF. We see that on January 28, 2005, USD/CHF begins trending upwards. The move lasts for seven days, at which time we initiate a short position on the open of the eighth candle. Our entry price is 1.2243, and our stop is 10 pips above the high of the previous candle, or 1.2272. This means that we are risking 29 pips on the trade. Our first target is then our entry price minus 29 pips, or 1.2214. It is reached on the very same day as our entry, at which time we immediately move our stop to breakeven and place a take-profit order for the second half at 1.2156, which is our entry price minus three times the amount risked, or 87 pips. The second target is hit the very next day, and we end up earning 58 pips on the entire trade.

## Part 2

### High Probability Trading Setups

#### Setup 7 - Seven-Day Extension Fade, GBP/USD

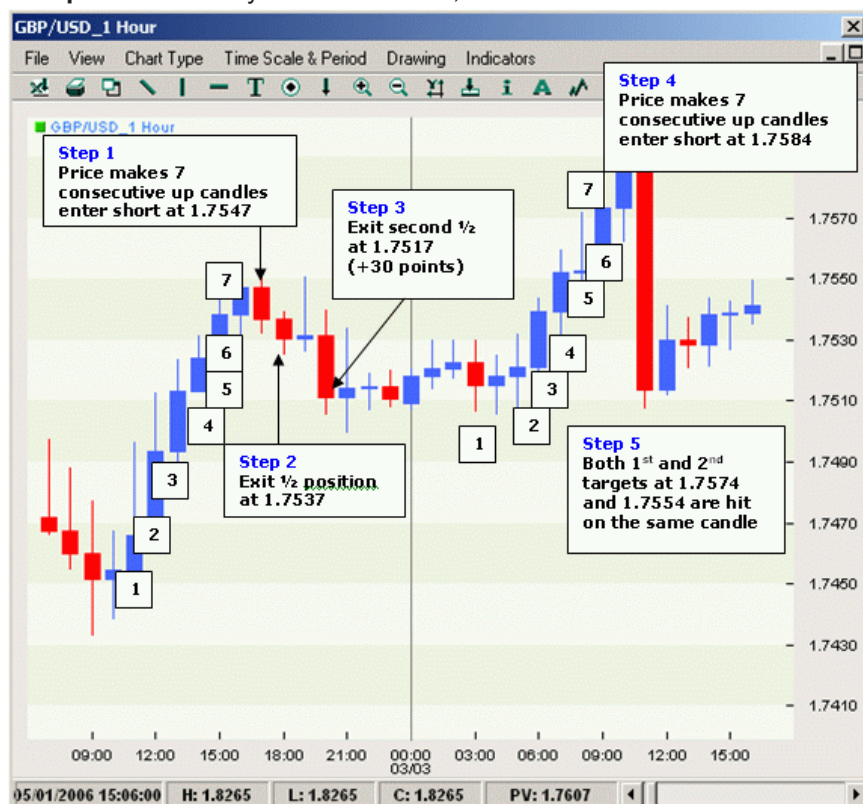


Figure 7 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The next example of the Seven-Day Extension Fade strategy is actually a double hitter. We are looking at an hourly chart of the GBP/USD from March 2, 2006 to March 3, 2006. The first scenario of the strategy unfolding can be found on the left side of the chart. We see that the GBP/USD begins to rally shortly after the open of the U.S. trading session. The rally lasted for exactly seven candles, right up until the U.S. market close. At 5pm EST, or the eighth candle, we place an order to sell at the candle open, putting us into a GBP/USD short at 1.7547. Our stop is 10 pips above the high of the previous candle, or 1.7557. The risk here is tiny, only 10 pips, which means that our first target is also very close at 1.7537. The second target is three times the amount risked, or 1.7517. The first target is hit within the same bar. The second target is reached three hours later, earning us 20 pips on the entire trade.

In the second example on the right hand side of the same chart, we see that the GBP/USD begins to rally shortly after the release of the stronger-than-expected U.K. service sector PMI report. The rally lasts right up until the 10am U.S. economic releases, totaling seven consecutive hours. At

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10am EST, the market was expecting the University of Michigan Consumer Confidence survey and the non-manufacturing ISM report. The stronger ISM number turned the market bullish dollars and the GBP/USD began to collapse. Without even anticipating the economic figures, at the close of the seventh bar, we go short GBP/USD at 1.7584 with stop 10 pips above the previous candle's high, or 1.7594. Since our risk is only 10 pips, our first take profit of 1.7574 is easily achieved. With the strength of the reversal, our second take-profit order at 1.7554 is also hit within the same hour, earning us another 20 pips on the entire trade. The risk for both of these trades is small, which makes the take profit also naturally lower as well. However, in both examples, the more nimble take-profit levels also helped us catch the near bottom of the moves. The retracements did extend in both examples during the same hour but ended by the next candle.

**Setup 7 - Seven-Day Extension Fade, USD/CHF**



Figure 7 - 5

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

We will take a look at the hourly charts for an example of a failed trade since we sense that most readers will be too impatient to wait for the rare, yet potent, seven-day extension fade on daily charts and instead will often try to implement them on hourly charts. The example above is a USD/

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### High Probability Trading Setups

CHF chart from March 2, 2006. We see that USD/CHF begins to sell-off immediately after the U.S. market open. The sell-off continues to seven candles, and on the open of the eighth candle, we place an order to go long the currency pair at 1.2991 with a stop 10 pips below the low of the previous candle, or 1.2974. Unfortunately, the weakness extends for another bar before it actually reverses, and we get stopped out for a loss of 17 pips. The loss is small and manageable, but more importantly, it highlights how some bouts of weakness can extend for eight candles before fully retracing. This is where discretion comes into play, since some traders may opt to try the trade again at the open of the ninth candle.

#### Setup 7 - Seven-Day Extension Fade, AUD/USD

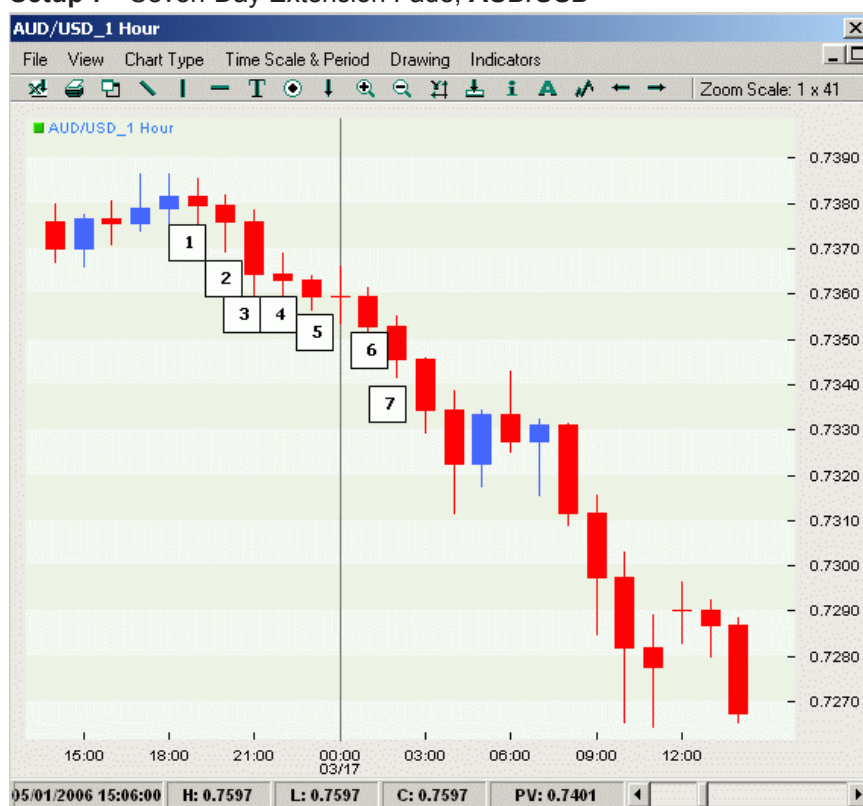


Figure 7 - 6

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

There is also one more point that we want to bring up that is illustrated in the hourly AUD/USD chart shown above. We count seven candles and look to enter at the open of the eighth candle. However, we see that the open is already the low of the previous candle, which tells us that in all likelihood, the move is set to continue for at least another bar; therefore, we choose not to take this trade. At bare minimum, we want to see the open be at least five pips above the low of the previous

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### High Probability Trading Setups

candle to show that we are buying into some sort of strength.

One interesting observation as illustrated in many of the examples above is that when we do catch a turn, it usually extends for far more than three times risk. Therefore, this is certainly a strategy that can involve more discretion whereby you as a trader may want to simply trail your stop using a two-bar high to capture more gains. Alternatively, if you find the fade setup on the daily charts, you may want to trail your stop using hourly charts. The whole premise of this strategy is based on the well-worn saying that “what goes up, must come down”. We are looking for exhaustion based on the need to bank profits, sometimes it happens in five bars, most times after seven, but occasionally not until the eighth bar. It is not a question of whether it will happen, but simply a matter of when.

## 8. Turn to Trend

Most traders have an extremely hard time trading with the trend. This observation may seem counterintuitive since the majority of traders always claim that trend trading is their preferred approach to the market; but after analyzing the records of thousands of retail traders, we are convinced the opposite is true. While everyone pays lip service to the idiom of “the trend is your friend”, in reality most traders love to pick tops and bottoms and constantly fade rather than trade with the trend.

This setup recognizes the desire of most traders to find turns in the price action (that is to buy low and sell high), but does so in the overarching framework of trading with the trend. The setup uses multiple time frames, moving averages and Bollinger band “bands” as its tools of entry. First and foremost, we look at the daily charts to ascertain if the pair is in a trend. We use the 20-period daily simple moving average to determine the trend. In technical analysis there are numerous tools that can help us diagnose trend, but none are as simple and effective as the 20-period SMA. Although there are arrays of other moving averages that traders can use, the 20-period moving average comprises a full month’s worth of data (20 business days), and as such provides us with a very good idea of an “average” price. Therefore, if price action is above the “average” price, then we assume the pair is in an uptrend and vice versa: if the price action is below the “average” price we assume it’s in a downtrend.

Next, we move to the hourly charts to pinpoint our entries. In the turn to trend setup we will only trade in the direction of the trend by buying highly oversold prices in an uptrend and selling highly overbought prices in a downtrend. How will we determine our overbought and oversold extremes? The answer is by using Bollinger band “bands” to help us gauge the price action. Bollinger bands measure price extremes by calculating the standard deviation of price from its 20-period moving



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### High Probability Trading Setups

average. In the case of hourly charts, we will use Bollinger bands with three standard deviations (3SD) and Bollinger bands with two standard deviations (2SD) to create a set of Bollinger band channels. When price trades in a trend channel most of the price action will be contained within the Bollinger “bands” of 2SD and 1SD.

Why then do we use the 3SD and 2SD settings in this particular setup? Because the Bollinger “band” rule applies to price action on the daily scale. In order to properly trade the hourly charts, which are more short term and therefore more volatile, we need to accommodate to those extremes in order to generate the most accurate signals possible. In fact, a good rule of thumb to remember is that traders should increase their Bollinger band values with every decrease in time frame. So, for example, with five-minute charts, traders may want to utilize Bollinger bands with setting of 3.5SD or even 4SD in order to focus on only the most oversold or overbought conditions.

Moving back to our setup, after having established the direction of the trend we now observe the price action on the hourly charts. If price is in an uptrend on the dailies, we watch the hourly for a turn back to the trend. If price continues to trade between the 3SD and the 2SD lower Bollinger band “bands” we stay away, as it indicates a strong downward momentum. The beauty of this setup is that prevents us from guessing the turn prematurely by forcing us to wait until the price action confirms a swing bottom or a swing top. In our example, if the price trades above the 2SD lower Bollinger band on the closing basis, we enter at market using the prior swing low minus five points as the stop. We set our target for the first unit at half the amount of risk, and if it is hit, we move the stop to breakeven for the rest of the position. We then look for the second unit to trade up to the upper Bollinger band and exit the position only if the pair closes out of the 3SD-2SD Bollinger band channel, suggesting that the uptrend move over.

#### Rules for the Long Trade

- 1) On the daily setup, place a 20-period SMA and make sure that the price is above the moving average on a closing basis.
- 2) Take only long trades in the direction of the trend.
- 3) Move to the hourly charts and place two sets of Bollinger bands on the chart. The first pair of Bollinger bands should be set to 3SD and the second pair should be set to 2SD.
- 4) Once the price breaks through and closes above the lower 3SD-2SD Bollinger band channel on an hourly basis, buy at market.
- 5) Set stop at swing low minus five points and calculate your risk ( $\text{Risk} = \text{Entry Price} - \text{Stop Price}$ ). (Those traders who want to give the setup a little more room can use swing low minus 10 points as their stop.)
- 6) Set profit target for the first unit at 50% of risk (i.e., if you are risking 40 points on the trade then place a take-profit limit order 20 points above entry).

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### High Probability Trading Setups

- 7) Move stop to breakeven when the first profit target is hit.
- 8) Exit second unit when price closes below the upper 3SD-2SD Bollinger band channel or at breakeven, whichever comes first.

#### Rules for the Short Trade

- 1) On the daily setup, place a 20-period SMA and make sure that the price is below the moving average on the closing basis.
- 2) Take only short trades in the direction of the trend.
- 3) Move to the hourly charts and place two sets of Bollinger bands on the chart. The first pair of Bollinger bands should be set to 3SD and the second pair should be set to 2SD.
- 4) Once price breaks through and closes above the upper 3SD-2SD Bollinger band channel on an hourly basis, sell at market.
- 5) Set stop at swing low plus five points and calculate your risk ( $\text{Risk} = \text{Entry Price} - \text{Stop Price}$ ). (Those traders who want to give the setup a little more room can use swing high plus 10 points as their stop.)
- 6) Set profit target for the first unit at 50% of risk (i.e., if you are risking 40 points on the trade, then place a take-profit limit order 20 points above entry).
- 7) Move stop to breakeven when the first profit target is hit.
- 8) Exit second unit when price closes above the lower 3SD-2SD Bollinger band channel or at breakeven, whichever comes first.

## Part 2

### High Probability Trading Setups

Now let's look at some examples:

#### Setup 8 - Turn to Trend, EUR/CHF



Figure 8 - 1

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Taking a look at the EUR/CHF daily chart, we see that since the middle of March 2006, EUR/CHF has traded above its 20-day SMA, indicating that it is in a clear uptrend.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, EUR/CHF

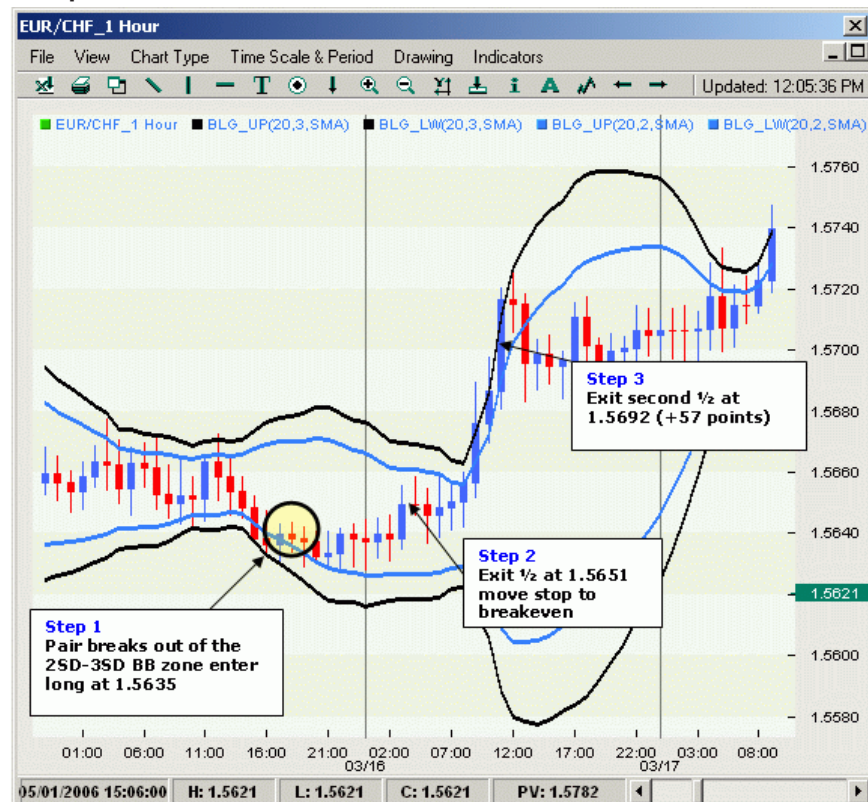


Figure 8 - 2

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Turning to the hourlies, we wait until the pair breaks out of the lower Bollinger band 3SD-2SD zone to go long at market at 6pm EST on March 15, 2006, at 1.5635 with a stop at 1.5623, risking only 12 points. (Note that EUR/CHF tends to be a very low volatility currency pair providing us with very small risk setups. Because the risk is so small, we may choose to set our target at 100% of risk rather than the usual 50% of risk.) Regardless of our choice, we are able to take profits at 3am EST on March 16, 2006, at 1.5651, banking 16 points on the first unit. We then move our stop to breakeven on the rest of the position and target the upper Bollinger band. We wait for the price to pierce the upper Bollinger band, trade within it and only when it falls out of the upper Bollinger 3SD-2SD band channel do we exit the rest of the position 1pm EST on March 16, 2006, at 1.5692, earning 57 points on the second lot - not bad for a trade on which we risked only 12 points!

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, USD/CAD



Figure 8 - 3

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

The next example of USD/CAD shows a classic turn to trend setup after it establishes an uptrend on March 7, 2006.



## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, USD/CAD



Figure 8 - 4

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

We move from the dailies to the hourly charts and wait until prices recover above the lower Bollinger band, entering a long at market at 11am EST on March 16, 2006, at 1.1524. We place our stop at 1.1505, which is the swing low minus five pips for a miniscule 19-point risk. At 10pm EST on March 16, 2006, as price makes a burst upward, we sell half the position at 1.1540 and move our stop to breakeven, locking in 16 points of profit. After price makes another burst higher, we exit at the first hint of weakness, when the hourly candle closes below the 3SD-2SD Bollinger band zone. This occurs at 11:00 on March 17, 2006, and we close out the rest of our position at 1.1587, for a 63-point profit on the second half of the trade.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, GBP/USD



Figure 8 - 5

Source: FXTrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

This example is a short trade. On February 15, 2006, we look at the daily chart and see that the GBP/USD is trading below its 20-day SMA, which indicates that it is in a clear downtrend.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, GBP/USD



Figure 8 - 6

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Next we turn our attention to the hourly chart and try to enter a high probability short when the price becomes overbought on a shorter-term time frame. We do this by waiting for the GBP/USD to close below the 3SD-2SD upper Bollinger band channel, at which time we sell at market (1.7440) and place our stop at approximately 1.7500, risking 60 points. As per our rules, we cover half the position at 1pm EST when price approaches the 1.7410 level, which is 30 points, or 50% of our risk. Next we move our stop at breakeven and hold the position, targeting the lower 3SD Bollinger band. Notice that the downtrend re-establishes itself with a vengeance and price declines into our zone. We stay in the trade until the price breaks back out of the lower Bollinger band channel, indicating that downward momentum is waning. At 6am on February 16, 2006, we cover the rest of the trade at 1.7338, for a profit of 102 points.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, USD/CHF



Figure 8 - 7

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Here is another good example of why we always scale out of our positions. On March 15, 2006 USD/CHF is in a downtrend, but the pair begins to trade back up to the 20-period SMA on the dailies. Since we can never be certain beforehand whether this is a retrace or a real turn in the trend, we adhere to the rules of the setup to control our risk.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, USD/CHF



Figure 8 - 8

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Looking on the hourly charts we see that at 1pm EST on March 21, 2006 the price closes below the upper Bollinger band 3SD-2SD level, and we enter a short at market at 1.3021. Our stop is placed five points above the swing high at 1.3042, for total risk of 21 points. At 6pm EST on March 21, 2006 the price reaches our first target of 1.3008, and we cover one lot for 12 points of profit or approximately 50% of risk. Simultaneously we move our stop to breakeven. At this point the trade begins to move against us, but our breakeven stop insures that we do not lose any money and, in fact, still bank 12 points of profit on the first half of the position.



## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, EUR/GBP



Figure 8 - 9

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Finally, let's take a look at an example of a failed setup. Starting on March 3, 2006, the EUR/GBP breaks above the 20-period SMA and establishes an uptrend on the daily charts.

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### High Probability Trading Setups

#### Setup 8 - Turn to Trend, EUR/GBP



Figure 8 - 10

Source: FXTrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Using our turn to trend approach, we wait for the pair to make a swing low in the 3SD-2SD Bollinger band zone and then enter long at .6881 at 10am EST on March 14, 2006. The swing low was created at 7am EST that same day at .6878, so we place our stop at .6873, five points below the swing low, risking a total of eight points. Note that the EUR/GBP pair is a very slow-moving cross with very high pip values. A point in the EUR/GBP is worth approximately 175% of a point in EUR/USD, so an eight-point risk in EUR/GBP would translate into a 14-point risk in EUR/USD.

Initially, the price makes a small rally but then drops to .6873 at noon EST on March 14, 2006, taking out our stop. This turns out to be the exact low of the move, and many traders may find it incredibly frustrating to be taken out of a trade just before it has a chance to turn around and generate profits. Not us, however. We realize that getting stopped on a bottom tick is just a part of trading and will probably happen more times than we care to remember. Far more important is to appreciate the risk management aspect of the trade, which leaves us only with a slight loss of eight points, thus preserving our capital and allowing us to look for other high probability setups. To

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### High Probability Trading Setups

truly appreciate the importance of this dynamic, just imagine the following scenario. Instead of a stop loss, we leave the trade open and instead of turning around, it proceeds to drop even further. Before long, we may be looking at a floating loss in hundreds of points - something that would be inordinately more difficult to make up than our initial small eight-point stop.

#### Turn To the Carry - a Different Flavor of the Setup

Turn to the carry is a variation of the turn to trend setup designed for longer-term traders interested in trading in the direction of the positive carry. It has several modifications that make it different from turn to trend, but the general idea behind the setup operates on the same principles of finding entry at the most advantageous pivot points in price action. For those who have the patience of longer-term moves, the strategy creates fewer, but more potent trades.

First and foremost, the setup is only traded in the direction of the carry, which is the direction of positive interest. So in the case of pairs, such as AUD/JPY, the strategy is only traded from the long side; while on the other hand, in EUR/GBP the setup would only be traded on the short side. Note that these rules are set at the time of the writing of this book (May, 2006). Should sometime in the future the Japanese yen yield more interest than the Australian dollar, or the euro carry a higher rate than the British pound, then these rules would be reversed. The one consistent rule, however, is that the trader must trade only in the direction of the currency with the greater interest rate advantage.

Secondly, the turn to the carry uses only daily charts and employs Bollinger “bands” with settings of 2SD and 1SD instead of the 3SD-2SD combination of the former setup. The longer time frame is designed to help the trader capture daily interest rolls while remaining on the right side of the directional move. Furthermore, because we are looking for deeper turns in the price action, the break of the 2SD-1SD zone is required to trigger a trade signal. The following are the rules for the turn to the carry variant of this setup.

#### **Rules for the Long Trade**

(When the Carry Positive Currency is the Base Currency)

1. Place two sets of Bollinger bands on the daily chart. The first pair of Bollinger bands should be set to 2SD and the second pair should be set to 1SD.
2. Once the price breaks through and closes above the lower 2SD-1SD Bollinger band channel, buy at market
3. Set the stop at swing low minus 5 points and calculate your risk (Risk=Entry Price - Stop Price).

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### High Probability Trading Setups

4. Set profit target for the first unit at 50% of risk (i.e., if you are risking 100 points on the trade, then place a take-profit limit order 50 points above entry).
5. Move stop to breakeven when the first profit target is hit.
6. Exit second unit when price closes above the upper 2SD Bollinger band, or at breakeven; whichever comes first.

#### **Rules for the Short Trade**

(When the Carry Positive Currency is the Counter Currency)

1. Place two sets of Bollinger bands on the daily chart. The first pair of Bollinger bands should be set to 2SD, and the second pair should be set to 1SD.
2. Once the price breaks through and closes below the upper 2SD-1SD Bollinger band channel, sell at market.
3. Set the stop at swing high plus five points and calculate your risk ( $\text{Risk} = \text{Entry Price} - \text{Stop Price}$ ).
4. Set profit target for the first unit at 50% of risk (i.e., if you are risking 100 points on the trade then place a take-profit limit order 50 points above entry).
5. Move stop to breakeven when the first profit target is hit.
6. Exit second unit when price closes below the lower 2SD Bollinger band, or at breakeven; whichever comes first.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, AUD/JPY



Figure 8 - 11

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

Here is an example from the May 2005 to June 2005 period in AUD/JPY when turn to the carry generated two signals - one was successful and one was not. Let's take a look at the unsuccessful trade first. In the middle of May, we see the currency pair close above the 2SD-1SD Bollinger band, and we enter long on the close of the candle at 81.92. The next day, the price inches higher but fails to meet our first profit target and proceeds to fall. Over the next three days the decline accelerates, and we are stopped out of the trade for a 97-point loss. Some readers may wonder why we waited so long before liquidating the position. The answer lies in the fact that every trader must walk a fine line between controlling his losses and giving the trade enough room to succeed. Using the swing low offers a logical reference point as it is the final price before new lows in the currency are set, and therefore represents the last exit point for most longs. Once that barrier is broken, it could mean that new information has changed the perception of value of most market players, and prices could collapse further. Of course, sometimes prices could simply test a new bottom and then quickly rebound, but making that assumption could be devastating for the trader if he is wrong; because in a highly leveraged market like FX, one bad decision could blow



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### High Probability Trading Setups

up an entire account. Therefore, no matter how frustrating it may seem to be stopped out just as prices reverse (to be bottom ticked in trader's lingo), professional traders never let such temporary annoyances affect their judgment and always stay disciplined.

Two days after we are stopped out, a new turn to the carry opportunity presented itself, and once again we go long, this time at 81.34. Our risk is a bit smaller this time, at only 70 points. Within three days the pair rallies to our first profit target, and we exit half the position at 81.70, banking 35 points and move our stop to breakeven. The trade proceeds in our direction for several more days and we still sit tight, collecting the interest spread in the meantime. Eventually, on May 26, 2005 the AUD/JPY rallies to the upper 2SD Bollinger band, and we exit the rest of the position on strength, harvesting 106 points on the second half of the trade. In addition to 141 total points of profit, we also received approximately 22 points on interest during our time in the trades. Although over the course of two trades we still ended up a bit in the red, the setup showed the power of a disciplined approach in real-life trading. By sticking to our risk parameters and entry rules, we were actually able to neutralize most of the losses of the first trade and maintain our capital in good shape for possible opportunities in the future.

That opportunity occurred in August of 2005 in the same pair, as the turn to the carry setup presented itself once again.

## Part 2

### High Probability Trading Setups

#### Setup 8 - Turn to Trend, AUD/JPY



Figure 8 - 12

Source: FXtrek Intellichart, Copyright 2001 - 2005 Fxtrek.com, Inc.

On August 25, 2005, the AUD/JPY pair breaks out of the lower Bollinger band channel and closes at 83.55, prompting us to go long at the open of the next bar with a stop at swing low of 82.60. Note that for the next few days, the pair actually moves against our position, dipping slightly. This price action happens often in this setup as pairs try to work off temporary overbought conditions. Although the price recedes, it never triggers our stop, and we remain in the trade, collecting interest in the meantime. Approximately a week later on September 2, 2005, the AUD/JPY rallies to our first profit target of 84.00 (which represent nearly 50% of our risk), and we bank 45 points and move the stop on the rest of the position to breakeven. The very next day, AUD/JPY dips to within a whisker of our stop but does not tag us out. We remain in the trade as it rallies higher for the next three days until finally on September 8, 2005, we exit on the close as price pierces the upper Bollinger band. The second half of the position generates 181 points of profit. Furthermore, the two-week holding period produces 25 additional points of profit in interest. Altogether, we are able to harvest 251 points on the long AUD/JPY, or approximately 125 points per every lot traded.

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### High Probability Trading Setups

Putting all of the trades in the AUD/JPY in perspective, we can see how a disciplined methodical approach pays off over the long term. Although the first trade turned into a loser, costing us 190 points ( $-97 \times 2 + 4$  points of interest earned); the second trade garnered 141 points in profit and approximately 20 points in interest, nearly offsetting most of the losses. Finally, the third trade generated 226 points of profit and 25 points of interest, so that, overall, we walked away collecting 222 points of profit across all of the trades, clearly proving that trading FX is a marathon and not a sprint.

### Final Thoughts on the Turn Trade

Finally, there are some further variations on the turn trade for you to consider. Those traders who don't like to assume the full risk all the way to the swing low or swing high of the trade can consider using the low/high of the trigger candle as a much tighter stop point. The risk in the strategy will be reduced significantly, but at the cost of having far more frequent stop outs. In the first example, the stop would be set at the low of the trigger candle, which would be 81.53, or only 40 points away from the 81.92 entry, effectively cutting our risk in half. The same approach, however, would cause an unnecessary stop out on our second example, as the slight dip in price would take us out from our 83.55 entry at 83.12, generating 43 points of stop losses before getting us into the trade once more on August 30, 2005 when we had another positive candle close above the 1SD Bollinger band. Altogether the -40 points and -43 points of loss would still add up to less than the -97 points of loss on the first trade; traders who like to be "right or be out" may want to consider this variation on the trade.

Last but not least, the turn to carry trade is clearly a longer-term strategy, which may be ideally suited for the weekly charts; however, one word of caution. Weekly charts could generate extremely wide stops causing the risk-reward parameters to be highly unfavorable. Therefore, being selective on which turn to carry setup to take is crucial for successful implementation of this idea. The following chart illustrates this case well.

### Part 3

# Factoring in Fundamentals: Most Important Event Risks

96 Five Most Important Pieces of Economic Data

97 USD

98 EUR

99 JPY

100 GBP

## Part 3

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Factoring in Fundamentals: Most Important Event Risks

# Five Most Important Pieces of Economic Data

While all of the setups that we teach in our book are technical in nature, we never forget that event risks can quickly overturn your positions. Unlike most technicians, we never rely on charts exclusively. We acknowledge the power of fundamentals and choose our trades using both disciplines. Therefore, the last section of our book covers the five most important pieces of economic data for the U.S., Europe, Japan and Great Britain. These are pieces of economic data in addition to central bank monetary policy meetings that you must know in order to trade effectively in the currency markets.



## Part 3

### Factoring in Fundamentals: Most Important Event Risks

## \$USD

Economic Release	Definition	Frequency	FX Impact (High/Low/Medium)
<b>Non-Farm Payrolls (NFP)</b>	A component of the Bureau of Labor Statistics Employment Report, which is probably the single most important report on economic activity	First Friday of every month (usually)	Extremely High impact as job growth is key to the health of the economy and is one of the primary drivers of Central Bank monetary policy
<b>Trade Balance/CA</b>	A measure of the trade between the U.S. and the rest of the world	Monthly	Medium to High. Typically FX market grows concerned when CA begins to exceed 6% of GDP, which will frequently lead to a downward adjustment in the currency
<b>Treasury International Capital System (TICS)</b>	Treasury International Capital System, the Treasury Department's report on net foreign purchases of U.S. securities	On or about 11th Business Day of Each Month with 1.5 Month Lag	Medium to High. Though only two years old, the TICS has become one of the most important reports on the calendar as its surplus values serve as critical offsets to the trade deficit figures
<b>Gross Domestic Product (GDP)</b>	The value of all final goods & services produced in the U.S.	Quarterly (updated monthly)	Medium. Though backward looking, this report is an important measure of overall economic activity and can have impact on the market when it deviates strongly from expectations
<b>Consumer Price Index (CPI)</b>	A measure of the change in prices for a fixed basket of goods & services for a typical urban consumer	Monthly	Medium. The index has become controversial for under-representing the true costs of food, transport and housing, but still retains an impact - especially if it shows consistent growth rate above 2% in the core readings

## Part 3

### Factoring in Fundamentals: Most Important Event Risks

## € EUR

Economic Release	Definition	Frequency	FX Impact (High/Low/Medium)
<b>IFO Survey</b>	A gauge of German business confidence, based on executives' inputs	Monthly	High. The IFO is the most important sentiment gauge of Eurozone business sentiment and often foreshadows business activity
<b>Retail Sales</b>	A measure of sales of many forms of retail outputs, which is important for estimating private consumption	Monthly	Medium to High. As the primary indicator of consumer spending, Retail Sales provides a critical clue to the strength of the economy
<b>Consumer Price Index (CPI)</b>	A measure of the change in prices for a fixed basket of goods & services for a typical urban consumer	Monthly	High. ECB has a 2% inflation threshold. If inflation is above 2%, they lean towards hawkishness, if it is below 2%, they lean towards neutral or dovishness
<b>Gross Domestic Product (GDP)</b>	Value of all final goods & services produced in the Euro area	Monthly	Medium. It can impact the market primarily when the number registers a surprise reading
<b>EZ Unemployment</b>	Percentage of the workforce that is unemployed	Monthly	Medium. Unemployment data is often leaked ahead of time; therefore has limited value

## Part 3

### Factoring in Fundamentals: Most Important Event Risks

## ¥ JPY

Economic Release	Definition	Frequency	FX Impact (High/Low/Medium)
<b>TANKAN</b>	The most important survey of corporate sentiment in Japan	Quarterly	High. Japanese corporate sentiment can have far-reaching implications on the growth of the economy; therefore the impact of the Tankan is high
<b>Gross Domestic Product (GDP)</b>	Value of all final goods and services produced in Japan	Monthly	Medium to High. It can impact the market primarily when number registers a surprise reading
<b>Consumer Price Index (CPI)</b>	A measure of the change in prices for a fixed basket of goods and services for a typical urban consumer	Monthly	High. Japan has been mired in deflation for more than a decade, so inflationary data is often critical to forecasting future monetary policy
<b>Household Spending</b>	The current income and expenditures of consumer households	Monthly	Medium. Again, household spending plays a key role in gauging the strength or weakness of deflationary pressures
<b>Eco Watchers Survey</b>	A measure of the general business sentiment of sector employees working in industries close to consumers, such as barbers, taxi drivers, and waiters	Monthly	Medium The man in the street survey is often the best indicator of economic activity in Japan

## Part 3

### Factoring in Fundamentals: Most Important Event Risks

## £ GBP

Economic Release	Definition	Frequency	FX Impact (High/Low/Medium)
<b>Retail Sales</b>	Monitors the volume and value of retail sales, composed of food, non-specialized stores, clothing and footwear, household goods, non-store retailing, and other non-food	Monthly	High. Consumer spending comprises 70% of U.K. economy and, therefore, is critical to its health
<b>IP/Man P</b>	Output indexes of production industries, composed of mining, quarrying, oil and gas extraction, manufacturing, and electricity/gas/water supply	Monthly	Medium to High. Manufacturing and Industrial output still matters to U.K. economy, especially in the export sector
<b>Harmonized Index of Consumer Prices (HICP)</b>	A measure of the change in prices for a fixed basket of goods & services for a typical urban consumer	Monthly	Medium to High. Inflation is critical mandate for the Bank of England; and like the ECB, the BoE has a 2% HICP target
<b>U.K. Unemployment</b>	Unemployed individuals actively seeking work & claiming unemployment	Monthly	Medium to High. Unemployment has crucial impact on future consumer spending and therefore growth
<b>Royal Institute of Chartered Surveyors (RICS)</b>	The Royal Institution of Chartered Surveyors (RICS), a professional body representing property professionals and surveyors of all types, publishes a survey of U.K. housing	Monthly	Medium. Housing has been a key contributor of asset wealth in U.K. and changes in its value have a meaningful impact on U.K. economy