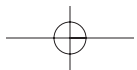
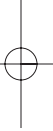


CHAPTER **1**

Trading ForeX



Trading ForeX

You may be asking yourself, “Why haven’t I heard of this market before now?” If this trading market is relatively new to you, don’t feel like you are alone.

Let’s explore what every trader or investor needs to know about Forex. The foreign exchange or “Forex” (also called the spot market) is the largest market on the planet. This is an irrefutable fact. Its average \$1.5 trillion to \$2 trillion traded per day is almost 100 times that of the \$25 billion of the NYSE. And while we will be discussing this in depth later, remember, size has its advantages.

The Forex market may seem like a new market to those of us in the United States but in actuality this market has been around for many years. There are two developments that brought Forex trading to life and to the United States. First was the decision that led to the free-floating market we trade today. The catalyst was President Richard M. Nixon’s decision to abandon the gold standard in 1973. Subsequently, the fixed-rate system fell apart and currency values were set by supply and demand. Second was the Commodity Futures

Modernization Act of 2000 approved by Congress on December 15, 2000, and signed into law by President William J. Clinton on December 21, 2000.

The Commodity Futures Modernization Act is a significant step forward for U.S. financial markets. This important law creates a flexible structure for regulation of futures trading, codifies an agreement between the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission to repeal the 18-year-old ban on trading single stock futures and provides legal certainty for the over-the-counter derivatives markets.

Before late 1999, Foreign Exchange was largely unknown to the U.S. public because retail Forex brokerages simply did not exist in the numbers they do today nor were they regulated. The Commodity Futures Modernization Act allowed the CFTC (Commodity Futures Trading Commission) to regulate and oversee

the Forex Exchange brokerages. Subsequently, most Forex firms became members of the National Futures Association.

We now know that the Foreign Exchange isn't anything new, so why are we hearing so much about it now? As with many things in life and trading, it's all about timing. Once the Commodity Futures Modernization Act was passed, regulated retail brokerages starting popping up. With zero commissions they should have garnered some attention back in 1999–2000, but they didn't. Why? Well let me ask you, do you recall what was going on back in 1999? The U.S. stock market was three solid years into a rally, the likes of which cast a shadow on all other markets! Also a factor was the introduction of two very popular futures contracts. The Chicago Mercantile Exchange (CME) introduced the E-Mini S&P 500 and Nasdaq 100 contracts in September 1997 and June 1999, respectively. Consider that most futures traders were already familiar with well-established currency contracts traded through the CME and didn't know of the alternative. Subsequently, not a lot of people cared that the foreign exchange market was now regulated and retail brokers were ready to take orders online.

As with all cycles, what goes up must go down, and all great traders and

investors never stop looking for a market to put their money into. The Foreign Exchange market offers the best trading hours (24-hours a day!), massive liquidity, no commissions, no margin calls, leverage, and no gaps. And if this wasn't enough, most brokerages will guarantee stop-loss orders. The only guaranteed stops I have seen were only in my dreams!

No Gaps and Guaranteed Stops.

There are no gaps in this market and stops are guaranteed. You may be wondering, "Did I read that correctly?" Yes, you did. Because the market doesn't have any gaps, you never have to deal with gap opens. The 24-hour trading and massive liquidity virtually guarantee that your stops will be executed without slippage. Although you should check with your brokerage, most firms offer this guarantee Sunday through Friday. As an experienced stock and futures trader I know better than to ask for that from my futures or stockbroker. The futures and stock markets simply can't offer traders this guarantee mainly because of limited trading hours that result in frequent gap opens.

For those of you who may be new to the concept of "gaps," a gap open occurs when a market opens higher or lower

than the last trading session's close resulting in a literal jump or "gap" in prices. Any stop-loss orders priced within this gap will not be executed at the stop-loss price but rather will become market orders at the next available price. Ouch!

24-Hour Accessibility and Liquidity

The Forex market is open 24 hours, six days a week, opening Sunday evening (EST) and closing Friday afternoon. Let's imagine waking up on Tuesday morning. While New York was sleeping, Sydney, Tokyo, Singapore, Hong Kong, Frankfurt, and London were all trading at various times. London is the most active time zone in the Forex and it is five hours ahead of New York. If New York is considered the center of the stock universe, then London is the center of the Forex universe. Since this is truly a global market, as one time zone finishes trading for the day, another is just beginning or already underway. News and short-term fundamentals have very little to no long-term impact because of the 24-hour, worldwide participation. News can be "digested" over time instead of being concentrated into a 7½ hour trading session like the stock market.

There is no physical location where Forex is traded because it is an "interbank

exchange" and is traded electronically through a network of banks, phones, and the Internet. Besides being open 24 hours a day, the Forex market is as large as it is because it is not located in a single city or exchange. In this way it differs greatly from the New York Stock Exchange or the Chicago Mercantile Exchange, both of which trade at a central exchange.

Diversify Your Approach and Portfolio.

Investing in stocks, bonds, and real estate are common ways to diversify a portfolio. Unfortunately, most people do not fully realize the benefits of including currencies to a portfolio. Think of currencies like the stock of a country. Currencies offer a market with high leverage and guaranteed stops. It is also a great market to diversify into because with just six U.S. dollar currency pairs to track, it isn't a time-consuming market to analyze.

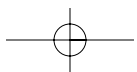
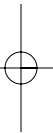
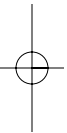
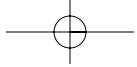
Scandals, Manipulation, and News.

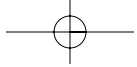
While I am a chartist (that means I believe that the news is built into the price action), I do acknowledge that reports can and do effect the Forex markets in the short term. Many times these economic events can be the catalyst of, for example, a breakout or pullback. However, because of the size of the Foreign Exchange market, the effects of news and

other outside influences are limited, quickly absorbed, and frankly, react in a more logical fashion. Think of it this way: If you had 10 people in a room and wanted to make them react a certain way to an idea or fact, it probably wouldn't be terribly difficult to change the minds of at least half or more. What if you wanted to do the same to 1,000 or 100,000? What about one million people? How effective would or could you be? Well the Forex trades \$1.5 trillion to \$2 trillion in currency a day, worldwide, 24 hours a day. This size alone makes it very difficult to manipulate. Even the well-documented Bank of Japan intervention had limited effect on the USD/JPY!

Currencies don't have accounting scandals or wayward CEOs. Consider that because the foreign exchange mar-

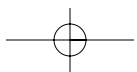
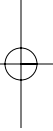
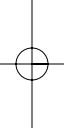
ket is open 24 hours a day, each country can react to whatever relevant information is available at that time. This is precisely why the Forex reacts so logically to news and fundamentals. Many times economic and world events have already been factored into the market by the time New York opens. Because the market is continually open, starting in Sydney and moving on to Hong Kong, Tokyo, Singapore, Frankfurt, London, and New York, it allows the news to be digested by each time zone. Moving from one time zone to another "dilutes" any sudden or extreme reaction that is typically found in domestic markets where there is limited trading hours and where reactions are often exaggerated because many of the participants react to news or fundamentals all at one time.





CHAPTER 2

Getting Started



Getting Started

The market is one of the greatest teachers. It reveals itself to all of us each and every day if we are willing to pay attention. Too many times we try to box it, label it, or beat it.

In the end, all we need to do is study and measure it. With that end in mind, this book is predominately about the specific tools and strategies of trading. In fact, I kept a “sticky note” above my computer screen as I wrote reminding me of my goal: Write a book that could make me a trader again if I forgot everything I knew.

I endearingly labeled this endeavor to friends and family members as the “teach myself to trade from scratch if I got amnesia” book.

If you’ve been at this trading game for any length of time, you have undoubtedly bought many books. From my experience, most are what I have come to call “glossary education” books. These are those books that include a few paragraphs to a few pages on every conceivable pattern and indicator available, but no real methodology. It’s full of definitions and explanations, but when you’re through reading it you’re no closer to a step-by-step methodology than you were

before reading the book. It’s the difference between general information and applicable knowledge.

And just in case I haven’t made it abundantly clear, we’re here seeking knowledge, my friends.

When I was first getting into trading I didn’t know where to start. I had various mutual fund accounts and shares of IBM stock, which I wanted to trade using market timing. Mind you this was years before the Internet as we know it now. I would call my broker or look up quotes in the daily paper and plot the close by hand on my father’s old engineering graph paper. Eventually I started trading commodities and I bought a subscription to a service that would mail me charts once a week that I could update by hand until the next set of charts were mailed to my home the following week.

As with many traders who become bored with end-of-day trading, I soon started active trading—“daytrading”—

and sought out intraday charts. So I ordered a service that delivered quotes and charts via satellite. One thing became clear in a hurry: high-tech tools weren't going to make me a trader; having a methodology was going to be the key.

My number-one problem was that I didn't have a methodology. Books on the subject of trading were not nearly as readily available as they are today. So I did the next best thing, I made phone calls to people that I thought could tell me how to get started. I was 17 years old and decided I would phone the people on my list of traders and make a donation to their favorite charity in their name if they would talk with me because I figured they wouldn't talk with a "kid" who was calling out of the blue. Funny enough, I think between my youth and unusual offer, everyone on my list took my call, most by appointment. They were generous with their time, many spending an hour or more answering questions. This time was invaluable but not for the reasons you would think, though.

None of them revealed some closely held secret to trading. (Matter of fact, in hindsight, many of them were actually portfolio managers and investors rather than traders, but it didn't matter.) They all shared one common while dispensing their advice: trade and risk management.

Each of them, all in their own unique way, explained it wasn't so much how you got in the trade, but how you managed it that mattered. When discussing trade or risk management, they all had a set of steps they'd go through, beginning with a matrix of questions they'd asked themselves as they analyzed their positions. From these professionals, I learned the power of asking the right kind of questions when in a trade. Their time was invaluable to me and I am forever grateful to them. And whenever I have a chance to share my experience—successes and failures—I do what those people were gracious enough to do for me: offer my time generously.

After reviewing my notes from those conversations, I knew I needed a blueprint. A blueprint would allow me to "build a trade" the same way over and over again. It would allow me to use a set of tools in a consistent manner. I began to visualize myself as a "trading carpenter." My next problem was that after reading all the glossary books I could get my hands on, I was no closer to finding a set of specific tools that would answer the three questions all traders must ask themselves:

- 1. Where to enter the market?**
- 2. Where to set my profit targets?**
- 3. Where to set my stop-loss?**

This book is dedicated to answering the above questions. It is important to know pertinent facts about the market you are trading, but if the information doesn't answer the three questions just mentioned, it is not helpful or necessary information. In my opinion, traders shouldn't concern themselves with much more than price action. **A chartist or technical trader believes that news is built into price action.** And it is with this philosophy that a chartist or technical trader can participate in any market as long as it is liquid. (A **liquid** market is a market

that has enough volume to enter and exit quickly and without significant slippage.)

After reading this book, you will have learned a three-step formula to enter and exit the market, intraday and end-of-day. You will have a set of tools to consistently answer the three questions all traders must ask themselves. Most importantly, you will have a time-tested methodology using classic charting tools from which you can trade the Forex markets! *And let me share a little "secret" with you...I trade all markets this way: stocks, futures, and Forex!*

CHAPTER **3**

History Repeats Itself

The Five Mistakes Traders and Investors Make

HISTORY REPEATS ITSELF: The Five Mistakes Traders and Investors Make

There are a number of different methods traders and investors have used to make money in the market. Ranging from fundamentals to technicals, tape reading to charting, the methods to success are as varied as the participants in the markets.

But we all tend to make the same dumb mistakes when we lose money. We're going to discuss the top five because without exception these mistakes are repeated over and over again like a skipping record we won't stop playing. So let's try and stop that cycle right here, right now.

Mistake #1: Trying to Pick Tops and Bottoms

I know what a rush it is to pick a top or bottom successfully. But if the goal of trading is to make money, then the adrenaline rush must be left to our more adventurous pursuits like skydiving and motorcycles. Trading against the trend is a high-risk approach. There are tools that I will teach you to use so that you know exactly where you are within the context of the trend. Even better, you will know

when the market is directionless. Don't try to pick tops and bottoms in the market. Go learn to ride a motorcycle instead. It's more fun and less risky for your wallet.

Mistake #2: Not Selling a Losing Position

Have you heard these words before? "I can't get out now, I'm losing too much." Unrealized losses are still losses. Some losses are only temporary and within the parameters of the stop-loss, traders call it **heat**. Only you can decide what sort of heat you will take. The trades you choose to take will be based upon that tolerance. As traders we must distinguish between heat and losses that are losing trades that we refuse we accept, even when they have broken our stop-loss level. Before entering any trade, you

should know at exactly what price the trade becomes “valid”—this is your entry price. We should also know at what price the trade would become “invalid,” and this is the level we love to move around: our stop-loss. Solid trade management is the only way to control the tendency of not adhering to your original stop-loss.

We must begin by defining price levels on the chart; we call these **decision levels**. At decision levels we look to our trade management rules and put our thinking caps on. If we do not predefine decision levels we will be tempted to take action when it is not warranted. Decision levels allow us to time our actions for the right moment. More important, it also allows us to relax until that time that we need to make a decision. This is an important aspect of trading. We can't be focused all day, continuously. We'd burn out! Decision levels allow us to focus our attention to only those times where prices are alerting us potential entries and exits. This reminds me of something I once read about golfer, Tiger Woods. He was explaining how he manages his time and focus:

My dad has always been a big believer in smelling the roses. I didn't understand that till I got older. It was his way of saying “Don't focus

on the task too long or you'll burn yourself out.” It was a great lesson, and it was also his way of saying the only real focus you should have is when you're getting ready to play the shot. Talk to your caddie; b.s.; talk to the crowd; look at other things. The game of golf is very beautiful; enjoy it.

I am going off on a slight tangent here, but it is something worthy of discussing as it gives us insight into how we handle the risks and rewards of trading. While I do not like to make comparisons between gambling and trading, there is one comparison that I think speaks volumes about the challenges a trader faces that a gambler does not. If we were to place a bet on a football game, we would do so before the game and then sit back and see what our choice brings. We can't change our bet at halftime or the fourth quarter. A football game has a start and finish. Conversely, a trade is a totally separate event. While the market has a definite open and close, a trade does not. We can change our mind, move our stop, and add to a winning or losing position. It's an event that has no beginning or end, unlike the football game. Because of this, trading poses completely different risk management issues and requires a

discipline level that events with a definite beginning and end do not.

Mistake #3: Getting Emotionally Involved in a Trade

This is the reason we don't sell a losing position. We take losses personally, we let our egos get involved, and we hate admitting that we are wrong. We tend to internalize market losses. Realizing a loss is a difficult step, there are five stages that are involved in accepting a loss, and we discuss each stage later in this book.

Mistake #4: Not Making Your Own Decisions

It's easy to be swayed by the news, CNBC, chat rooms, forums, etc. We begin to question our position or worse, we enter a trade based upon other people's opinions. The truth is it is a symptom of a much larger problem: not trusting your methodology. Rule #1 is that no one cares more about your money than you do. When we lack confidence, we give our decision power away hoping that someone or something else can help us. It's easy to understand why we tend to question ourselves. The same curious mind that wants to learn and got us into the market is the same mind that betrays us. Since there are always more indica-

tors and strategies we're begin bombarded with on a daily basis, we wonder "Could that work better than what I have?" And off we go, buying new books, courses, software, and seminars. I've been there, too. I've got boxes full of courses and bookshelves staked with books to show for it.

I would be kidding you if I told you that I don't get curious about these things too! I attend seminars and enjoy them immensely. I read trading books from cover to cover. I get out and meet other traders. This is all because I now have the confidence to sit and listen to others without supplanting what has worked so well for me. I don't have to change my methodology, but I can add new distinctions from what I learn from other traders. It wasn't always this way... there was a time that I was easily swayed or would think I "needed" (more accurately, I "wanted") a particular piece of software or needed to change my style. My husband and I have a saying: "Need" is a funny word. What we think we need is typically what we really just want.

I remember many, many years ago when I was trading with a gentleman who wanted to use a mechanical system to trade about 40-50 stocks. He had been using a trend following system and it had been somewhat profitable for him.

This software was about \$5,000.00 and enjoyed immense popularity in the late 90's... you know, when the market went straight up and (literally) chimpanzees were winning stock picking contests. He hired me to execute the trades since I was particularly good at order entry. And I have to admit the curiosity got to me... did this man know something I didn't? Could I be more profitable if I was a systems trader? I had never been a systems trader, and he was convinced he could make me one since I already knew so much about discretionary trading. For a couple weeks we did unbelievably well. I recall we were up about \$90,000 midway through the first month. Of course, the voice of reason in my head was screaming, "You're doing well because the market is trending, dummy!"

So I went back to my partner and told him what I thought: *"We'll give back our profits when this market enters a trading range because this [trend following system] will whipsaw us by buying highs and selling lows in a chop. We'll notice when the market enters a trading range but the system won't... to it everything is a trend and it will continue to trade that way."* It fell on deaf ears, because by then this gentleman had calculated projections of what we would make if we continued at the pace we were going...forgetting that the market tends

to chop about the same amount of time that it tends to trend. I don't think I lasted 30 days with my system trading partner, in fact I can't remember at all how we ended it. But I am eternally grateful for the lesson he inadvertently taught me. It wasn't that systems trading doesn't work—it does for some people—just not for me. He taught me what some fish find out too late: Every shiny, flashy object isn't a meal, sometimes it's a lure and that hook may land you in the frying pan.

So I returned to my home office and to the tools I understood well, tools that were well tested, and that I could use in a step-by-step manner day in and day out. I would not follow a "system" but rather become systematic. Doing this would allow me to follow a blueprint and "build a trade" in a consistent manner. To this day, any tools that I use must be able to answer the only three questions that are relevant in trading:

Where should I enter a market?

Where should I place my stop-loss?

Where should I place my profit targets?

Mistake #5: Putting All Your Eggs in One Basket

Diversifying is important for many reasons that you are probably already familiar with. Is it important to make sure that your portfolio is ready for good times

and bad, of course, and this means that a portfolio must be diversified into separate markets altogether. What I feel diversification does for a trader is this: It allows us to pick the best trade. If traders only watch a single market, they will tend to try to chase a trade or squeeze more out of a move than may really be there. If traders have alternatives, then they can sit back and let a trade come to them; they can wait for the best possible set up. This is what diversification does for a trader.

I was an avid S&P E-Mini trader for a couple years; in fact, there was a short time when that was all I traded. What a mistake that was! In a nutshell, I traded a high/low breakout method, and I found myself getting frustrated with the lack of breakouts and then a

lack of follow-through if the market did manage to breakout. Because I wasn't looking at much else, I would begin to squeeze more out of a trade than it truly merited. Luckily, I snapped myself out of that fairly quickly without too much damage done. You know how sometimes your leg or arm falls asleep? Well my head feel asleep! The experience reminded me to not be lazy—to keep my pulse on the markets—so that when one market flat lines, I can transition to another. There are six major pairs that I will teach you to trade, and with six different markets to track you won't have to chase a trade, you can let the trade come to you. And remember, to diversify means that we add something new to our approach or portfolio, not replace something else that is working.

CHAPTER 4

The Major Players

The Major Players

Many people know the name George Soros as he is synonymous with currency trading. His legendary British pound trade that “broke the bank of England” is well documented.

But what if I told you that a major bank has made over \$500 million trading Forex in a single year or that Warren Buffett has invested over \$10 billion in currencies? What if I said to you that companies like Coca-Cola, Merck, Dell, Intel, Toyota, and Dow Chemicals all speculate in the Forex market?

Major banks and corporations trade the Forex. Many of the reasons for the size and liquidity of the Forex are the banks and corporations that participate in this market. This is not a new market, however, it is new to individual traders and investors in the United States. To a large degree, because of the Commodity Futures Modernization Act we now enjoy access to this Forex market. For years, though, banks and corporations

have “secretly” participated and profited from this market. A few of the banks that are actively providing market liquidity are Credit Suisse, Bank of America, Goldman Sachs, and Morgan Stanley. Maybe you’ve heard of them. Corporations take participation in this market very seriously as many have in-house trading divisions or subsidiaries to handle their Forex trading.

Consider that only just over 5% of the activity is generated by companies and governments that do business in a foreign country and convert one currency to another to buy and sell goods and services. So what of the other 90-plus percent? Purely speculation! Because of its sheer size, there is little chance of market manipulation and a single insti-

tution dominating the Forex market. *It is for this very reason that the Forex markets adhere so well to charting and technical analysis!*

Even though there is no single dominating entity in the Forex market, there are some major players in this market, so let's discuss who they are. The Major Central Banks are responsible for monetary policy. The Federal Reserve, or the Fed is the central bank of the United States. The Bank of Canada or the BOC is the central bank of Canada and sets Canadian monetary policy. The ECB, or European Central Bank, is responsible for the monetary policy of countries in the European Monetary Union, or EMU. The Bank of England (BOE), the central bank of the United Kingdom, has total independence in setting monetary policy and its nine-member Monetary Policy Committee makes all decisions on interest rates. The Swiss National Bank or SNB, the central bank of Switzerland, is independent in setting exchange and monetary policy. The BOJ or Bank of Japan, is responsible for setting monetary policy in Japan. However, Japan's Ministry of Finance (MOF) controls all foreign exchange policy and therefore is still considered the most important monetary policymaker in Japan. Both the SNB

and BOJ will affect their respective currencies by making remarks and intervening to enforce policy. Because Switzerland and Japan are export-driven countries, there is a preference for a weaker national currency.

Corporations have become increasingly more interested in the foreign exchange. The main cause is the rapid globalization of world economies. A multinational corporation often needs to make payment to another country, which means that many times they must exchange their "home" (or national) currency to that of the country they must pay. In doing so, they are now exposed to depreciation of their national currency. Therefore these corporations have become major players in foreign currency, as they must offset the risk of exchanging national currency for foreign currency. They must hedge against currency depreciation, which will put them on safer financial ground when they make future payments. But corporations do not limit themselves to simply hedging against currency depreciation. The number of corporations speculating in the Forex markets has increased, and with their activity and buying power, they have a continuing impact. However, because the nature of their trading or speculation involves primarily

hedging, they tend to take a longer-term approach.

If there is anything I want to impress upon you, it is this: The Forex is a heavily participated market for good reason. Many of the banks and corporations I

mentioned earlier are actually making net profits from their speculation. Banks and corporations have had this “playground” to themselves for a long time. I want to encourage you to see why this has been the best kept secret *off* Wall Street.

CHAPTER **5**

Prime Trading Times

Prime Trading Times

There are so many aspects of Forex trading that I find appealing: liquidity, leverage, strong trends, no commissions, only six pairs to have to track versus over two dozen commodity futures contracts and 40,000 stocks, no gaps, guaranteed stop-losses... but my favorite aspect of this market is that it is open 24 hours a day, six days a week.

It's said that *the foreign exchange follows the sun around the world* because as one country is closing for the day, another is just opening up.

During the stock market boom, many people didn't have the luxury of watching the market during the day, so active trading was typically ruled out. On the east coast, most folks were already at work before the market opened and returned home well after the market closed. The Forex market is different, it opens Sunday evening and closes Friday afternoon. It trades 24 hours a day with excellent liquidity. What does **liquidity** mean to a trader? It means that there is enough trading volume to assure that you will be able to get into a trade when you want to, but more

importantly, you will be able to get out of a trade when you need to! This means that just about anyone can find a time that they can dedicate to Forex trading.

But what times are best? Even though Forex can be traded 24 hours a day, there are some times that are more liquid and better suited to particular currency pairs. The United Kingdom is the most active foreign exchange center followed by the United States, Japan, Singapore, China, Switzerland, Germany, France, and Canada.

Let's discuss the top three foreign exchange centers: The United Kingdom, Japan, and the United States. Together these three centers account for almost 70% of total foreign exchange trans-

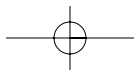
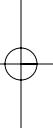
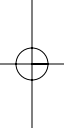
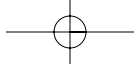
actions. London trades, from 3 AM Eastern Standard Time (EST) to 11 AM. London is five hours ahead of New York. Since London is responsible for over 30% of all Forex transactions, most of the large market participants trade during these hours. Since most major reports in the United States are released between 8 AM and 10 AM EST, this overlaps with the already active trading in London and affords some excellent opportunities for those of us on the “other side of the pond.” The most active pairs during London trading hours are the EUR/USD, JPY/USD, and the GBP/USD.

Between the hours of 8 AM and 5 PM EST, New York accounts for about 15% to 17% of Forex transactions. The U.S. market is active until about noon EST after which the volume will drop almost in half, due to London’s close. This brings up an important aspect of foreign exchange: **market overlap**. The most active market overlap is the New York morning session and the U.K. afternoon. Keep in mind that home or national currency moves in sympathy

with the equity markets of that nation, so the U.S. dollar will typically move with the equity markets.

Tokyo, despite its diminishing role as an active foreign exchange center, still holds one important distinction: It’s the first major market to open. Only about 10% of Forex transactions take place between Tokyo’s trading hours from 7 PM to 3 AM EST. However, many market participants will use this time to get a pulse of the trading day and begin scaling into positions. The most active pairs are the JPY/USD and AUD/USD.

Fear and greed rule the markets so emotion creates motion, and by knowing when the different pairs are most active we can gain an edge by knowing when specific markets are most likely to be on the move. However, if you are not a night owl or an early riser, have no fear. The majors all rely on the U.S. dollar in part to value the pair so when the U.S. market is open the U.S. dollar and the equities markets will move one another so there are plenty of trading opportunities for those of us who like our beauty rest.



CHAPTER **6**

Reading ForeX Quotes

Reading ForeX Quotes

When trading Forex, it is important to understand the price quotes. It may seem daunting at first, but I assure you it's easy to understand once you know what you are looking at.

First things first, the quotes are always presented in pairs. For example: the USD/CAD. This is the U.S. dollar versus Canadian dollar. Since the U.S. dollar is the first currency quoted in the pair it is known as the **base currency** and therefore has a value of 1. In other words 1 USD is equal to x CAD. If the current quote for the USD/CAD was 1.3910, that would mean that one U.S. dollar is worth 1.3910 Canadian dollars. Imagine flying to Canada, arriving at the airport and exchanging U.S. dollars for Canadian dollars. This would be a common example of the exchange rate.

There are six major currency pairs to watch. The U.S. dollar versus Japanese yen, U.S. dollar versus Swiss franc, U.S. dollar versus Canadian dollar, euro versus U.S. dollar, British pound versus U.S. dollar, Australian dollar versus U.S. dollar. The order in which the currency pairs

are quoted is not interchangeable: They are fixed. These six pairs are called the "majors." The majors make up almost 90% of daily trading activity.

The first three—the USD/JPY, USD/CHF, and the USD/CAD—all have the U.S. dollar as the base currency and are quoted like the Canadian Dollar example above. The last three—the EUR/USD, GBP/USD, and the AUD/USD—all have the U.S. dollar as the second currency and are quoted differently. Since the first currency quoted in the pair is called the base currency, the second currency quoted in the pair is often referred to as the "second currency" or the "counter currency." When the U.S. dollar is the second currency in the pair, the quote is presented as 1 base currency equals x U.S. dollar. So in an example where the EUR/USD quote is 1.1858, 1 euro is worth 1.1858 U.S. dollars. Let's

return to the airport scenario. If you flew into a EMU (European Economic and Monetary Union) participating country like Spain and presented your U.S. dollars in exchange for euros, using the example of the EUR/USD quote at 1.1858, you would have to give 1.1858 in U.S. dollars for each euro.

Now I'm not one to get bogged down in facts and history but I find it helpful to know which countries adopted the euro. Twelve of the countries in the EMU adopted the euro (EUR). Those twelve are (in alphabetical order) Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. Vatican City also adopted the euro. The euro is not to be confused with the ECU or European Currency Unit, which was actually a theoretical basket of currencies and not an actual currency as bank notes and coins never existed. The euro replaced the ECU concept.

It is when we turn to the charts that we can begin to visualize what the rates mean in terms of the trend. Let's return to the EUR/USD example. When this chart trends upward, it actually means that the euro is strengthening and the U.S. dollar is weakening. In other words, it takes more U.S. dollars to equal one euro. The same is true for the GBP/USD and AUD/USD.

When the U.S. dollar is the base currency (the first currency quoted in the

pair) and the chart is in an uptrend, the U.S. dollar is strengthening and the Canadian dollar, Swiss franc, or Japanese yen is weakening. So in the example of the USD/CAD chart, if it is trending up, the U.S. dollar is strengthening and the Canadian dollar is weakening. If the chart is trending down, the U.S. dollar is weakening and the Canadian dollar is strengthening.

A **pip** (price interest point) is like a tick in the stock or futures market. It is the smallest increment of point movement. How do you find out which decimal place in the quote is the pip? Look at the number furthest to the right in the quote; typically it is the fourth decimal place. For example, in a EUR/USD quote of 1.1847, the 7 represents the decimal place that is the pip. So a price movement from 1.1847 to 1.1848 would be a one pip move. All the majors, with the exception of the USD/JPY, have four decimal places and the pip is the fourth decimal place. With the USD/JPY (U.S. dollar vs. Japanese yen), there are only two decimal places, and the second decimal place is the pip.

The pip dollar value is different for some majors. The dollar value for each pip in the EUR/USD, GBP/USD, and AUD/USD is a fixed \$10.00. For the CAD/USD, CHF/USD, and JPY/USD,

it is not fixed, but rather fluctuates between \$7 and \$8.

What It Means to Trade in “Pairs”

Frankly, when I first began trading Forex it didn't really matter to me what “pairs” were. I had my charts and simply followed the trends and retracements, and that served me very well. It was just like when I was trading stocks back in the Internet heyday. It didn't matter much to me what the companies did just as long as there was good volume and a reasonable bid/ask spread.

It didn't take very long for Forex to become a larger part of my daily activity and I thought it prudent to learn more about these pairs and the relationship between the two currencies that made the pairs. Since I traded only the “major” or the U.S. dollar pairs, I knew I would have to watch a total of six pairs: the EUR/USD, USD/JPY, GBP/USD, USD/CHF, USD/CAD, and USD/AUD. The reason Forex is traded in pairs is because we are trading the exchange rate between two currencies. An **exchange rate** is the value of one currency against another.

Let's take the EUR/USD, for example. The EUR is the base currency, and the USD is the second or counter currency. If I am buying the EUR/USD pair, exchange rate tells me how much I have to pay in U.S. dollars to buy one euro. If the current quote on the EUR/USD is 1.2300, I would have to pay 1.23 U.S. dollars for one euro. If the U.S. dollar is the base currency, as in the USD/CAD, the exchange rate tells me how much I have to pay in Canadian dollars to buy one U.S. dollar.

When we are trading, we should think of the base currency as the main unit of your buy or sell. So if I were to buy the EUR/USD, I am simultaneously buying the euro (the base currency in this pair) and selling the U.S. dollar (the second currency). When I buy that pair I believe the euro will increase in value versus the U.S. dollar.

If I were to sell the EUR/USD, I am simultaneously selling the euro and buying the U.S. dollar, which means that I believe that the U.S. dollar will increase in value versus the euro. So now I hope you understand what it means to trade in pairs.

CHAPTER **7**

Tools of the Trading Game

Tools of the Trading Game

There are two decisions that I credit my trading success to. I've found that the decisions we make early on in any endeavor shape the final outcome.

For some fortunate reason, I decided early on when I was designing my blueprint that I would only use "objective tools" that could project specific price levels on the chart that would serve as entry and exit points. Objective tools are not subject to artful interpretation. A trendline is broken or it is not; an indicator is either showing strength, weakness, or it's neutral. I also decided that I wanted my entries and exits to be established well before I entered the trade, and I wanted these points to be relevant to the price chart and not some set number of points or percentage. Deciding valid risk and reward ratios based upon the price chart was the most important idea that I built into my blueprint. Think about it... *does the market really care that I have set a two-point stop-loss or that I only want to risk 3% on a trade? Does it matter if I want to make \$400 on the trade?* Do these arbitrary numbers have any bearing at all on price action or on support and resist-

ance levels on the price chart? You and I both know it does not.

Support and resistance are the most powerful tools I use to decide my entry and exit levels. There are many types of support and resistance: uptrends, downtrends, psychological price levels (or round numbers), moving averages, and Fibonacci Levels. Even though this book is about trading Forex, these tools and blueprint will work on any market or timeframe. And this is due to the nature of the tools: they are universal and robust. Which is simply "system-speak" for the fact that they will work well all on any market and they work consistently. Here's another piece of advice: Be wary of any trading system or tool that only works on specific markets or a specific timeframe. As long as a market is liquid, the tools I am describing will work for you.

Another point worth mentioning was a conscious decision on my part not

to rely on indicators for entries and exits. Indicators are to be used as confirmation tools. Since my setups rely on price and chart patterns, it's as easy as glancing at the indicator and taking a quick read on whether it confirms what my price or chart pattern set up is showing. Remember, indicators are all calculated by some combination of adding, subtracting, multiplying, and dividing the market's open, high, low, and close. Because of this, indicators will always lag price action. Indicators can be very helpful, though. I use what I have come to call "on/off indicators," as I only want to use indicators that clearly show buy, sell, or hold without having to determine whether a specific hook or cross has been made.

An on/off indicator can be simply defined as any indicator in which you can take a reading that tells you to buy, sell, or hold. It does not require that you recognize some sort of hook, cross, pattern, count bars, or any other nonsense that I have seen. You should be able to define an on/off indicator by telling

someone who knows nothing about trading that prices are either—for example—trading above or below a Moving Average or that the CCI (Commodity Channel Index) is plotting below the -100 or above the +100 level or that a MACD histogram is above or below the zero or signal line.

Keeping it simple with support and resistance, Fibonacci Levels, moving averages and on/off indicators in hand, I set out to build my step-by-step blueprint. The goal of trading is to find a methodology that will put you in the trade at the right time and more important, take you out of the trade at the right time. Even with that said, if the methodology is not easy to recognize, react to, and repeatable, it doesn't matter how good it is. The tools must be applicable! Furthermore, if you don't understand why and how I use the tools, it won't much matter because throughout this book my goal is to give you the confidence that you can trade successfully with these tools. So let's begin by discussing each tool in detail.

