Profiting From What the Market Doesn't Do

Sometimes in conducting our analysis and formulating trade ideas, it's important to notice what the market does not do.

The chart below is a 1-minute snapshot of the 6B (GBP FX Currency Futures, equivalent of GBP/USD for forex traders) from last night, Thursday 25 Mar 10.

The market was established in a downtrend with a clear larger-timeframe bearish bias. However the 30 min chart (not shown) has an area of major support at 1.4920-25, so this acts as a warning sign for a potential reversal.

Looking at our 1-minute chart, we see that the downtrend took us within a couple of pips of major support prior to pulling back to point A, which showed good rejection of higher prices via the upper tail. From A, price retested support on lower momentum offering a great trade opportunity up to B, although that's not the subject of this article.

The rally up to B occurred with wider than average range candles closing on or near their highs, on increasing volume - clearly bullish. The question then is whether or not this upwards momentum will be sufficient to change the trend and our longer-term bias?

The candle marked B is the narrow-range red candle right at the top of the rally. Note that this also occurred on the highest volume of the rally. A high volume with very little resulting movement, in this case indicates that the buying pressure that led to the rally is now being met with approximately equal selling pressure. Of note is the fact that buyers were not able to push candle B above the high of candle A (previous point of increasing supply). Subsequent candles would be required to resolve this battle of the bulls vs. bears.

Would this be a temporary pause before the bulls reasserted their dominance of the market, pushing above point A and establishing a new trend? Not this time. Following point B price action moved sideways for 7 minutes on low volume, unable to continue to new highs, showing no desire from the bulls to pursue higher prices.

Seeing that the market doesn't want to trade higher leads us to then look for a short opportunity if the pullback should fail. This occurs at C, with price falling on higher momentum, fueled by the orderflow of the previous longs either exiting their trades or being stopped out.
So, we've profited from 'what the market doesn't do'. In this case, the higher momentum move up to B shows that many were anticipating a reversal. When the market couldn't reach those new highs, these traders are forced to exit their position as they realize that their 'reversal' was really just another pullback in the longer-term trend.