The Engulf Method
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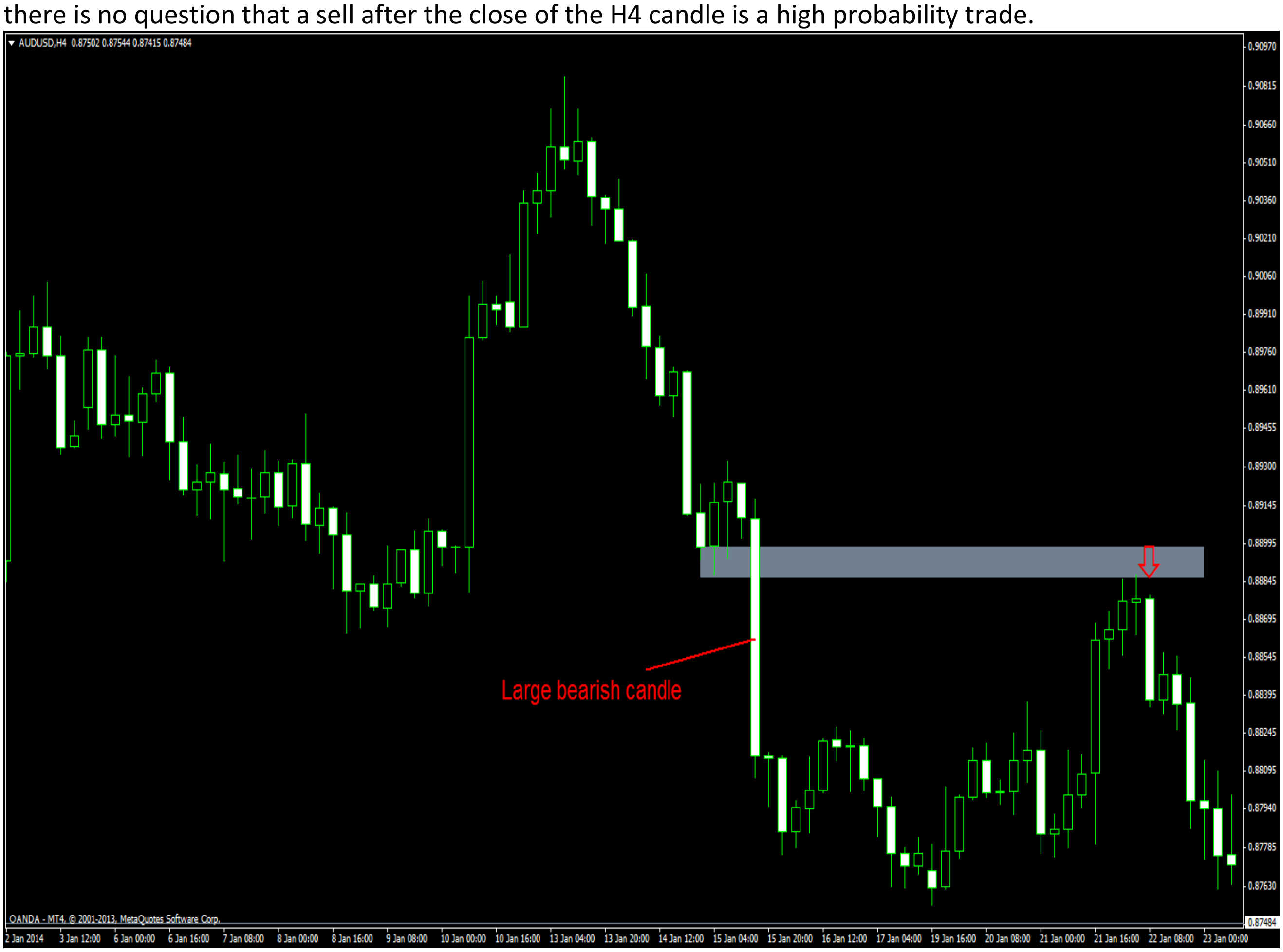
Introduction

Retail traders struggle to find proper entries and often resort to using indicators to provide trading signals. I believe price tells the trader exactly when to buy and when to sell without the use of indicators. As one reads about this method it will be apparent that it is similar to methods with strategies based in supply and demand. Although this may be true I do not have rigid rules about how to highlight so-called supply and demand zones nor do I have a set of complex definitions, price patterns or what-have-you. It is simply trading areas where buying or selling is likely to occur again. The price action in these areas are usually revealing. If there is anything peculiar about this method it is that I use the weekly charts to identify which pairs I will trade. But first let’s look at the method in a nutshell because it really is quite simple and uncomplicated.

The Method in a Nutshell

The chart below is a perfect example of what I look for to trade. The large bearish candle highlighted represents an area where sellers were highly motivated to push price down. Not only did the sellers move away from a brief area of consolidation, they also moved below an entire zone.   The thick horizontal grey line extends from the area where the sellers aggressively moved price down. It represents in general the area where sellers moved price down, but not exactly. Exactness is not important because the most important thing about this method is how price will react when it comes back to the grey rectangle area. It doesn't matter that it exactly reacts where the grey rectangle is only that it reacts somewhat close to it. The reaction we want to see should be obvious. In the chart below the reaction was a fairly impressive bearish H4 candle that engulfed three previous candles. To me there is no question that a sell after the close of the H4 candle is a high probability trade.



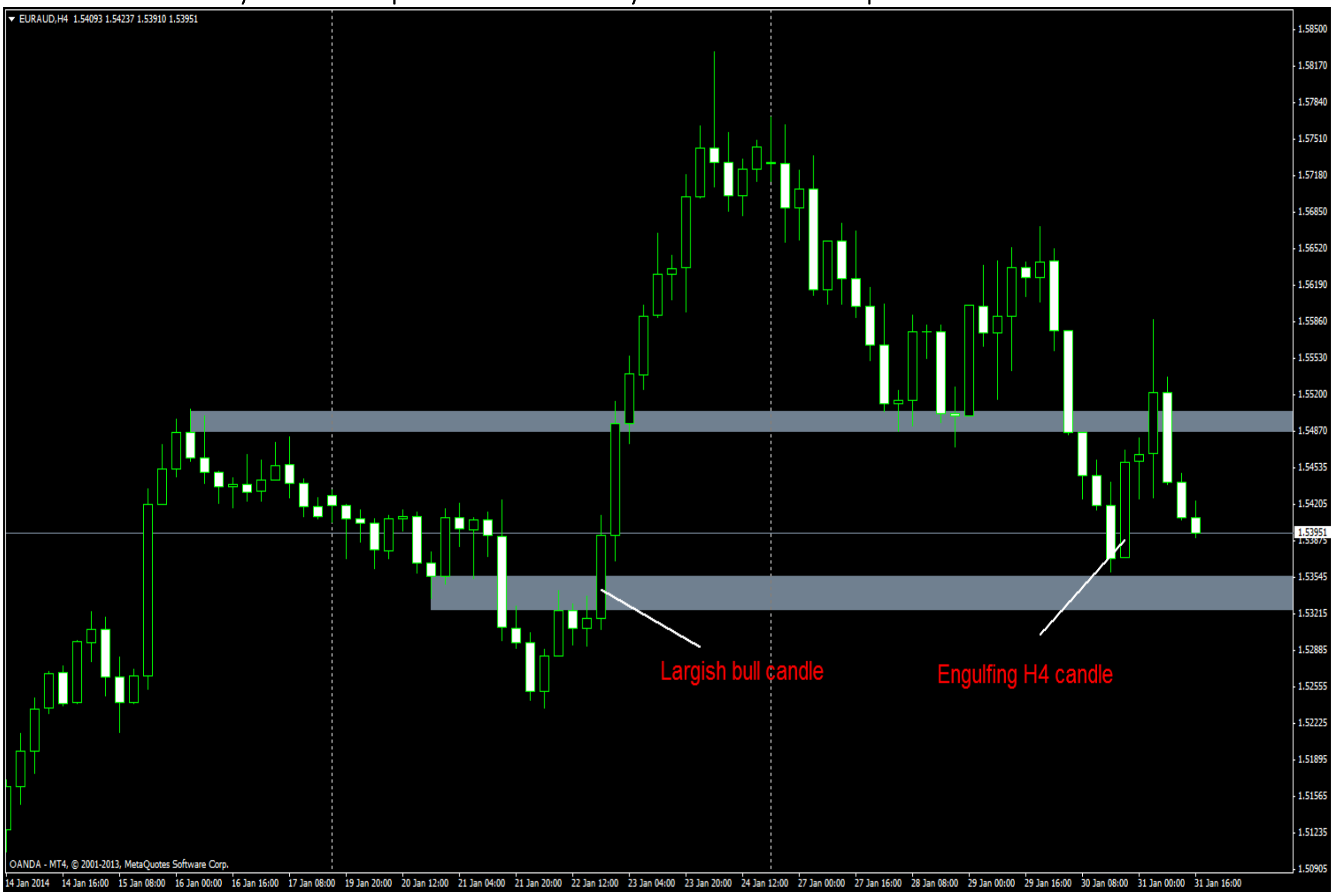
Finding Pairs to Trade

Essentially we want to trade pairs that are not ranging on the weekly time frame. I like to see price closing above or below an area of ranging or consolidation on the weekly time frame. This weekly chart shows price breaking out of a range. The breakout on top consisted of a few small weekly candles and was of no interest to me. The breakout on the bottom was with a generous bearish candle and interests me. I'm not married to any one or two or more pairs. I scan weekly charts at the close on Friday and choose FOREX pairs that have broken out of a ranging pattern or are clearly in trending mode on the weekly time frame. I will only look at these pairs for the following week.

Examples

The H4 chart below shows an H4 engulfing bouncing off resistance (previously support). This was a live trade I took 1/30/14 during Asian session and closed on 1/31/14. I actually took the trade on a H1 chart which is valid but H1 charts will give more false signals. Target was at the bottom of the previous swing low and it was a good thing because you can see the next H4 candle would have wiped out any profits. Price bounced again from the resistance and would have been a good trade on an H1 time frame. I prefer H4 trades as they are more reliable.

This is an H4 chart of EURAUD. The weekly chart was trending up so we would only be looking for buys. Price sliced through the top grey horizontal line but is of no concern since we are biased long. Since we trade bounces you can see waiting for price to close when it reaches your s/r area is crucial. If you "touch trade" these areas you are likely to get burned. Price then reaches the bottom grey area and although it doesn't quite touch it we get a very nice bullish engulfing bounce. The H1 chart would have given an earlier signal. Notice how price moves up then stalls. Taking your profit judiciously is important. More than one entry may be a good strategy if you like to take some profit early and let the other trade/s ride at break even. This is up to you. I'm not going to go into money management and risk to reward. This is a topic that could be discussed for many pages and can be found elsewhere. You should however study this. It is important and necessary to make consistent profit.



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I am interested in the natural movement of price between identifiable levels or areas on the chart. Price naturally bounces off these levels or breaks through them on its way to the next level. By choosing pairs with weekly biases as I have outlined above I am able to narrow down my trading to either buys in a bullish weekly market or sells in bearish weekly market. This results in a simplification of trading and eliminates “counter-trend” trading. Counter-trend trading is not necessary as you will have several pairs to watch. If you are looking for “trend-trades” and “counter-trend” trades at the same time you are likely to make mistakes.

Summary of the Method

1. On Friday’s close or over the weekend scan your Forex pairs on the weekly time frame and pick those pairs that are not consolidating in a range. They should have broken out of a range or already be in trending mode. Ignore all other pairs.
2. Look only at these charts for the rest of the week.
3. On the daily and H4 time frames look for support and resistance areas as I have shown previously. These are often highlighted by generously sized bearish or bullish candles projecting away from the s/r area. Finding these will take some practice but to help I will give some more examples on the H4 time frame.
4. Wait for price to come back to your s/r areas. We want price to bounce off these areas decisively with an engulfing candle or pattern.

Engulfing

A word about the word “engulfing”. I will often use the word to describe price moving decisively up or down. Often large engulfing candles (sometimes they are really just large bearish or bullish candles) highlight an area of interest. I do not adhere to the strictest definitions of engulfing candles. Engulfing to me is price in general breaking through a candle or series of candles in a way that suggests price is likely to continue. You may get a single large candle that completely engulfs the high and the low of the prior candle or one, two or three candles that completely engulf a series of prior candles or you may get an engulfing of entire price zone area.

James 16

The James 16 group has greatly influenced my trading and I am a member of the private forum where I keep a journal. J16 classifies engulfs more strictly. These strict definitions have served those that trade J16 style well. Learning these price action candles is a must for any trader in my opinion. I encourage anyone just starting out in trading or those struggling with their trading to read the James 16 thread. Reading the first 100 pages or so will serve you well.

Forex Factory

I have two threads on Forex Factory. Both are called the “The Engulf Method”. One is in the “trade systems” and the other is in the “trading journal” section. The journal is linked to a live trade explorer and it details every single one of my trades using this method starting January 2014.