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NO-FAIL FOREX

what to do when indicators
don't work and systems fail

NOTICE

Trading currency carries high risk. You should carefully consider whether trading currency is appropriate for you in light of your experience, objectives, financial resources and other circumstances. The author assumes no responsibility for nor makes any guarantees regarding the results of your trading activities.

contents

I didn't write this for experienced, sophisticated, well-heeled traders, or for Capitalist Cowboys, or Bar-Chart Bad Boys, or those guys with three monitors and a high-priced charting subscription.

This is for the trader who has tried repeatedly to trade successfully but watched in frustration as their account continued to plummet. It's for the trader who has used a dozen systems based on a dozen different indicators and a dozen combinations thereof; has devotedly followed the experts, commentators, and gurus; and has finally realized they could trade as successfully by flipping a coin.

This document originally consisted of notes to myself as I finally began to realize how to trade Forex. It developed further when friends asked me questions and I shared my notes with them, organizing and elaborating on the information. Eventually I began to hear from friends of friends, and that's when I decided to formalize what I had learned so I could share it with strangers in the form of an eDoc.

I'm not a Forex expert or guru. I don't have a holy-grail system and I no longer believe such a thing exists. I won't show you how to use a favorite indicator because I don't believe indicators – not even a simple moving average – are of any value whatsoever. I don't have a secret strategy that will let a robot trade for you as you kick back on the beach and sip margaritas while becoming a millionaire.

However, I *am* a professional Forex trader, defined as someone who earns their living by trading. About 95% of my trades are successful.

But it wasn't always like that.

It seems to be de rigor to brag about how much one lost before discovering or inventing the system that works.

Comparatively speaking, I never lost more than chump change. That's all I had to start with -- only a few thousand dollars between me and the street, and I'm not talking Wall Street. Being an intrepid soul, I gambled my sad little fortune on Forex. True to the usual course, I promptly lost it all.

Well, not quite all.

On the day of my enlightenment, I had enough equity left for one mini-lot trade – two if I stopped out with only a 10-pip loss. Best case, ahead of me loomed a long, slow climb back into solvency, one buck at a time, with no reason to believe I could do it. No reason, in fact, to believe anyone could do it. After all, it's common knowledge that "the primary cause of failure in Forex is undercapitalization." Less than $200 would surely qualify.
Furthermore, I had no plan for success. No system. I'd already tried a dozen no-

fail, holy grail systems, in addition to trend trading. My computer screen was littered with super-tweaked indicators, and I had all the discipline necessary to wait until every indicator in every timeframe agreed that I could safely trade in the direction of the trend. That's how I lost my little nest egg in the first place.

With my back to the wall, I stared glassy-eyed at the candles forming on the chart. I watched the Exponential Moving Averages cross. I gazed mindlessly at the MacD histogram. I noted absently that the ADX was trending. Then, disgusted, I deleted them all.

I read the morning Forex news, no longer smirking when the so-called experts contradicted themselves from one sentence to the next. It wasn't funny anymore.

I glanced at my bookshelf, stuffed with guru revelations and trading textbooks, and mused that I could burn them in the fireplace for warmth when my electricity was turned off.

I thought about the empty days ahead when I would no longer wake to my morning ritual of pouring a cup of coffee and checking the Forex. What would I do? Where would I go? How would I survive?

In this winning frame of mind, I prepared to make my last trade, to give it my final shot. And as sometimes happens, in the moment of ultimate desperation when all appears to be lost, I experienced an epiphany.

As I sat in a fugue state, staring at the chart on my screen, I suddenly recognized what had escaped me in the past. I saw the key to successfully trading Forex.

Since that day, I've often wondered what the deal is with all those trading systems. Are the "experts" misleading wannabe traders as some kind of sick hazing prank?

Maybe it's just different for people who trade million dollar accounts. Maybe there’s some secret that neither I nor anyone I know ever managed to discover. Maybe somehow these systems work if you have enough money to throw at them.

I don't actually believe that – I’m just being magnanimous. I suspect it’s a classic case of the Emperor’s New Clothes. That is, these systems don’t work for anyone, but by common consent the nonsense continues to be circulated while losing traders secretly blame themselves for not getting it.

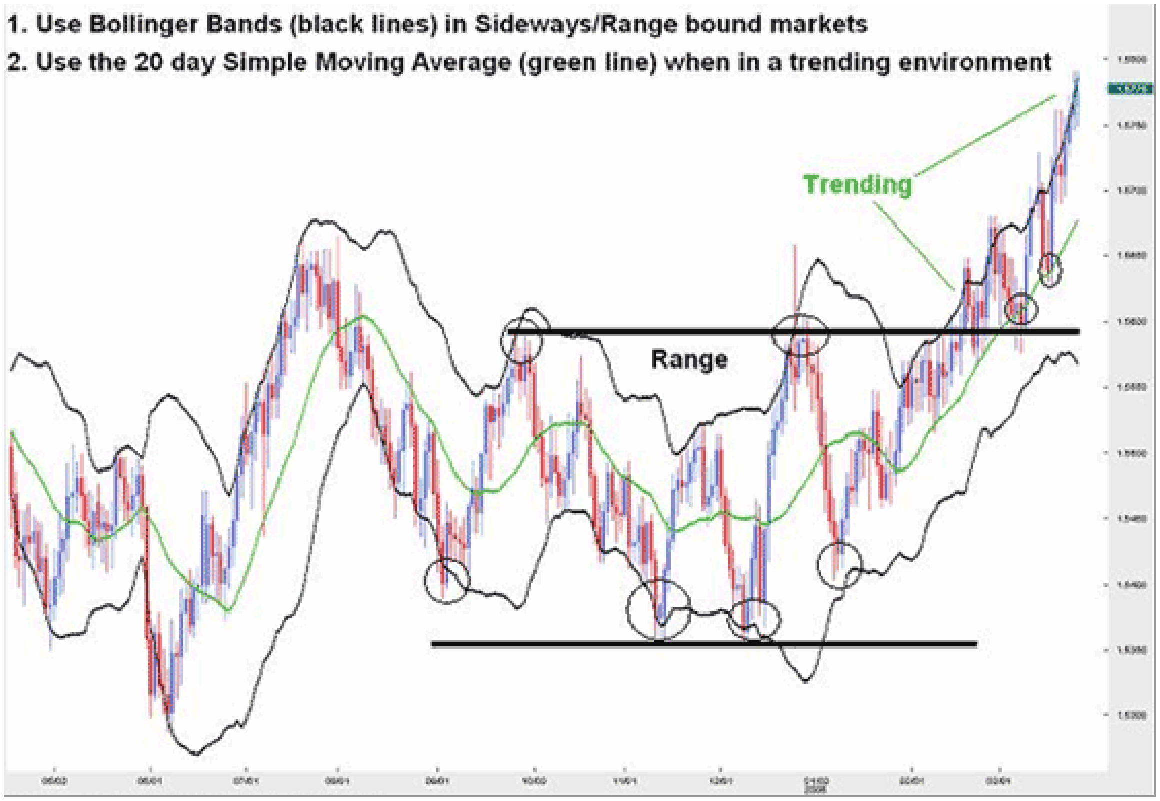
What I’m about to show you certainly isn’t the only trading method that works. But it *does work,* and I strongly suspect that it’s one version of the only method that works.

Here is the essence of my secret, my discovery, my epiphany. (Drum roll, please.) In a nutshell: the *only* "indicator" that accurately predicts market movement in Forex is … PRICE.

Price tells you whether to buy or sell, how much to invest, when to enter, when to exit, and where to place your stop. The only thing you need to know in addition to price is some fundamental information and common-sense trading rules.

If you're a newbie who is completely confused by Fibonacci and MacD, or you're like me not so long ago – angry, frustrated, and going down for the third time – take a deep breath, clear your mind, and relax. *It's not your fault.* You're not dense, jinxed, or doing something wrong. The systems and indicators that don't work for you don't work for anyone else, either. Some traders are honest enough to admit that fact and search for a real solution. They are the ones who will ultimately succeed.

The following chart originated with a popular Forex training resource. I won't name them because it is not my purpose to disparage anyone, but it is typical of charts that claim to illustrate the use and value of indicators.



Notice that they have applied Bollinger Bands as an indicator for trading when the market is ranging. They have drawn horizontal lines to show Support and Resistance of the range. They have applied a Simple Moving Average. And they have circled entry and exit points.

Looks great, doesn't it? Any idiot ought to be able to trade this, right?

But look again, and this time pretend you are trading it as it happens instead of looking at it in retrospect.

In fact, let's just walk through it, step-by-step.

I have added numbers to the chart, so you can more easily see what I'm referring to as I mention a few items that are not quite so obvious as the chart and the experts would like us to believe.

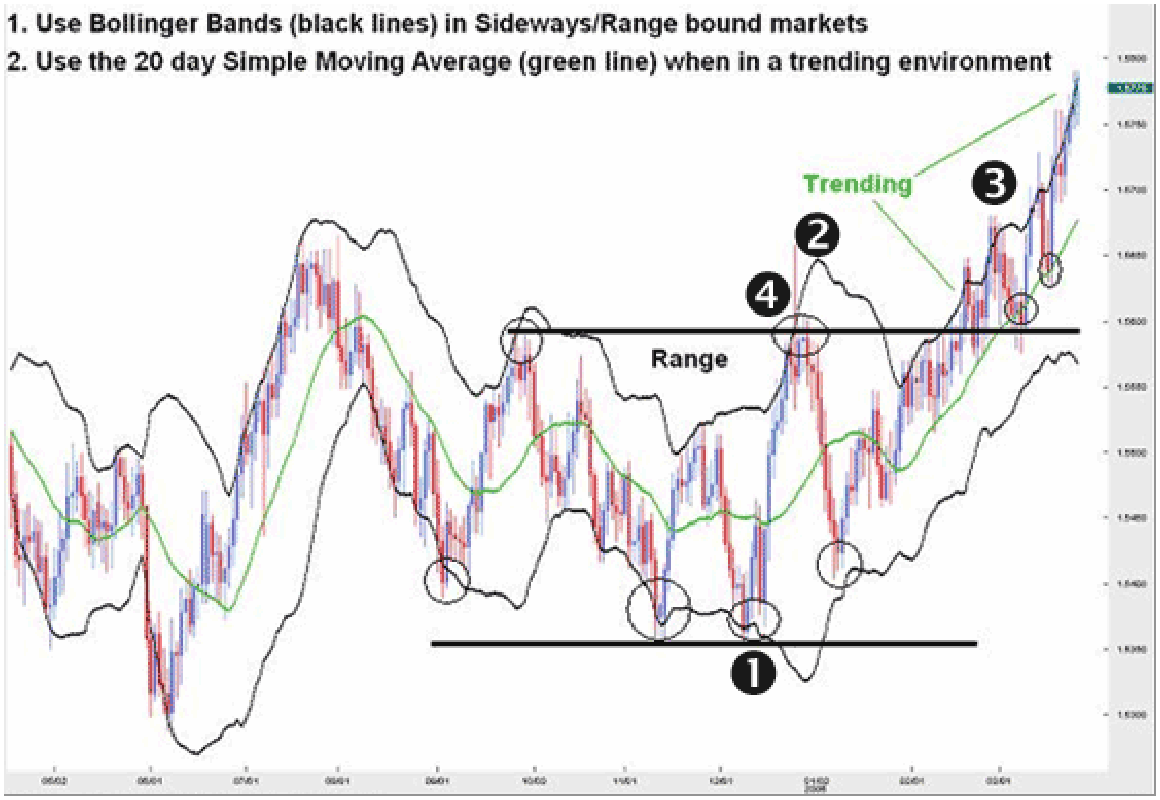


Fig. 1b

To begin with, you could not have drawn the Support line until the market had passed point ❶, and you could not have drawn the Resistance line until the market passed point ❷, so there was nothing to indicate you should have taken the trades preceding those points. Technical traders will claim you should have known because the price touched the bands, but as you can see, it is often impossible to know the price has touched the band and *turned around* until well after the fact. It often touches the band, turns around for a few points, turns around again for another few points, and turns again, until you are dizzy and thoroughly confused and a dozen pips poorer. Sometimes it goes through the bands, as at point ❹, but these incidences are conveniently ignored – although when history serves, devotees claim that breaking through the band indicates the beginning of a new trend.

And what about that new trend? You can't know it's happening until you've passed point ❸, and by that time, the entire movement is finished. You could have guessed, of course, because by then you could have drawn your Support and Resistance lines, but notice that point ❸ is at the same high as near point ❹, but the market wasn't making a new trend at point ❹ even though price broke through resistance *and* the band.

Are you confused yet? It's nothing compared to what happens when you try to actually trade this stuff. Bollinger bands, like all indicators, develop as the market moves. They can change direction at any moment, and they do. If you could accurately predict where the band was going to be in the future, you would be rich and famous. In real life, the computer is programmed to draw lines based on a mathematical formula applied to a certain set of manipulated historical price data, and one of the resulting designs is called Bollinger Bands. The computer references a different mathematical formula to make the pretty green line called a Simple Moving Average. This is all mildly interesting if you are easily entertained, but it won't tell you the price of the Euro two minutes from now.

Of what purpose is it to know, for example, the 200-day Moving Average? Well, we can listen to the experts tell us price is above the 200-day Moving Average. But what does that *mean* for prices ten minutes from now or one hour from now or even one day from now?

It could mean the market is in a strong uptrend. Or it could mean the market is overbought and about to take a dive. In fact, it means absolutely nothing. The information is accurate and specific, but *completely irrelevant to prognosticating market movement.*

All indicators provide a visual representation of some version of history. If well-tweaked, they'll tell you what has happened only a few seconds after it happens. What they won't do and can never do is predict the future.

Unfortunately, they make you think they can. That's because at first they appear to work perfectly. An indicator applied to a compatible market – that is, an oscillating indicator used when the market is ranging, or a moving average indicator used when the market is trending – can seem to forecast the future *so long as the market continues to do exactly what it's done*. Added to statistical chance, indicators work often enough to seduce you into believing what you want to believe – that if you find the holy grail system, you can make a fortune in Forex. But when chance runs out and the nature of the market changes, the indicator will invariably fail.

The first step to successfully trading Forex is to get all that stuff off your charts. You need to clear your mind and your vision, so you can see the only relevant information: what price is telling you. You should be looking at nothing more than a clean candlestick chart with a simple volume indicator.

When you first remove all indicators from your charts, it can feel like you're flying blind. You'll soon become accustomed to it and appreciate the look of a clean, simple chart. But don't fall into the trap of thinking you'll trade by price but just glance at your favorite indicator for confirmation. So long as the indicator is there, it will distract you, disrupt your focus, and subliminally influence your trades.

The only tools you need to successfully prognosticate price movement is support and resistance verified by candlestick formation.

Don't confuse S&R (support and resistance) with the overbought/oversold signals generated by an oscillating indicator such as the MacD. It's not the same thing at all. By the same token, all those complicated Japanese candlestick patterns with the poetic names won't do you much good either.

S&R addresses actual price in relation to established market value. Candlestick formation provides clues about how the market as a whole is evaluating the current price. Together they reveal the two necessary bits of information you need in order to place a winning trade:

- how much the market believes your currency is worth, and
- how eager they are to buy it from you.

That's all you need to know in order to place winning trades. You don't need to know the exponential moving average of the past 200 days, or the percentage of Fibonacci retracement, or any complicated, convoluted wave theories. The more elaborate and involved the process of acquiring the information you require, the more obscure and open to interpretation will be the results. Keep it clean, keep it simple, and remain focused on the fundamental information you need.

There are three market structures you can trade using S&R verified by candlestick formation. Listed according to level of risk from least to most, they are:

- Range channels
- Trend channels
- Initial Breakouts

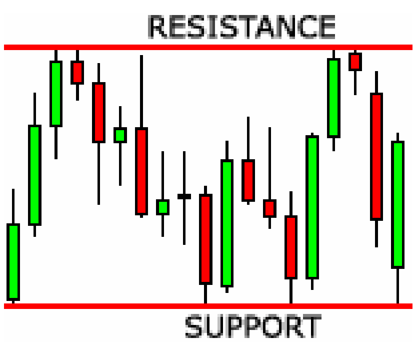
In other words, when the market is moving up, down, or sideways – which just about covers it all. However, there are times when the market is unstructured. During these times, you should not trade. It's simple to identify an unstructured market. It's when you have no objective factual reason to believe the market will move in a particular direction. If you can't state in one sentence precisely why the market will move in the direction you expect – based on something more than gut feeling – you have no business trading at all.

One of the biggest problems for new traders is that most trading advice – even that based on supposed holy-grail systems – is too general. For example, the ever-popular moving average cross systems tell you to open a trade when the fast moving average crosses above the slow moving average, (or is that vice versa?). When you try it, your first question will be: how far above should it cross? That's because you'll see it cross, almost cross, immediately cross back, until you have no idea *what* you should be doing and you've lost your spread repeatedly.

There are lots of high-probability, low-risk trade opportunities, once you know precisely what to look for. We'll take a detailed look at a couple of different setups, but all dependable, productive, high-probability, low-risk setups have one thing in common: they are based on support and resistance.

Support and resistance is the closest you'll ever get to the true holy-grail of Forex. Rational trading methods based on S&R remove all ambiguity and reduce risk to the absolute minimum.

*Knowing how to trade support and resistance, and understanding simple money management, are the **only** skills necessary to successfully trade Forex.*



A quick reminder: Support and resistance is created when the market changes direction each time it reaches a certain price level.

The top boundary is called resistance, as the market resists paying more for the currency. The bottom boundary is called support, as the market will not allow the price to fall further.

There is nothing complicated about drawing support and resistance lines. Simply connect two or more tops for the resistance, and two or more bottoms for the support. Don't get confused by experts with complicated systems claiming to reveal how to draw "correct" support and resistance lines that end up 20 points away from any place you might reasonably expect the price to bounce. Just connect two or more tops and two or more bottoms and be happy.

There are additional skills you can learn, such as hedging, that will enable you to increase your Forex income. But you can earn a high-profit, low-risk living from Forex by trading nothing more sophisticated than these two simple lines. For that matter, if you try to trade without them, you'll almost certainly lose.

I recently read a review of an expensive trading system. The reviewer was enthusiastic, crowing that he was capturing 100 pips per week on average. He also mentioned he couldn't wait until he could work the system well enough to capture 200 pips per week. After that, what – 300 pips?

Obviously, the sky is *not* the limit with this kind of thinking. At some point – *and long before 300 pips a week* – the goal becomes totally unrealistic.

Personally, I project my income based on 50 pips a week.

I know that even a poorly performing market will provide enough opportunities for me to capture at least 50 pips. But unless the market makes me an offer I can't refuse, I'm not too keen on capturing much more than 50 pips.

That's right. I don't *want* more than 50 pips a week. If I get more than 50 pips in an average week, I see red flags that warn I may be overtrading.

Overtrading is the leading cause of failure in Forex.

Despite what you've heard, it's not undercapitalization that results in disaster. Many people lose thousands and even tens-of-thousands repeatedly funding their Forex accounts in an effort to keep the dream alive. They had plenty of money. What they didn't have was an understanding of how to trade profitably with the money they had.

I've never read in any book or website what I'm about to reveal. And yet, it's common sense, and completely obvious the moment you think outside the box.

The way to riches is *not* in capturing more pips, because the more pips you try to capture, the more you increase your risk.

The way to riches is in trading an appropriate number of lots.

With only 50 pips a week, I can make $50 trading one mini lot.
Or $500 trading one standard lot.
Or $5000 trading 10 standard lots.

Yes, you can earn $5000 a week by capturing an average of 10 pips a day in one or two small, can't-lose trades.

Or you can chase after hundreds of pips, taking trades that look good instead of trades that can't lose, and in the process you will take losses that only increase the number of pips you must capture in order to reach your goal.

I don't have a pip goal. I've learned from experience that I tend to average 50-70 pips a week in a typical market, but I never focus on capturing x number of pips. I focus only on stalking the 100% can't-lose trade.

Except for the fact that any trade must offer more pips than I'm risking, I don't even care how many pips I can capture in a trade. Why should I care if I can only capture 5 pips, so long as the trade is 100% can't-lose? If some person approaches me on the street to hand me $50, will I turn him down because it wasn't $500?

Naturally, I grin when I capture an average week's pips in one trade, but I don't stop trading for the week in any case. No matter if I gained 5 pips or 50 pips, the moment I close the trade I'm back to square one: stalking the 100% can't-lose trade. Every day, five days a week, from 7am until noon, I sit in front of my computer, stalking the 100% can't-lose trade. That's my only criterion and my only goal. I won't take a 50/50 trade, regardless of how tight the stop. I won't take a 75% likely trade, or even a 99% likely trade. I trade 100% can't-lose at all times, and I make my money by trading multiple lots rather than chasing an ever-increasing number of pips.

Some days I don't make a trade at all.

You see, I don't get paid to trade. I get paid to accurately identify 100% can't-lose trades. That's my job. There are only two rules:

> If I fail to recognize a 100% can't-lose trade, I don't lose anything except one opportunity among many.
>
> But if I inaccurately identify a trade as a 100% can't-lose, I get penalized.

Consequently, I err on the side of caution. But as you can see, neither my goal nor my agenda has anything whatsoever to do with the number of pips captured.

Chasing after pips is a recipe for disaster. But in any case, it creates an artificial ceiling to your earnings, because there is a limit to the number of pips anyone can reasonably expect to capture. However, the number of lots you can trade grows naturally and realistically, building along with your equity as you become increasingly skilled at stalking the 100% can't-lose trade.

A range channel is the safest environment in which to trade. Anyone capable of following a few simple rules can trade Forex successfully if they trade only range channels.

A range channel happens when the market is trading sideways and forms a narrow channel with strong S&R, which it bounces off of repeatedly.

Here is an example:

As you can see, the only thing necessary to successfully trade range channels is to routinely open and close trades at the S&R. Once a strong range channel is underway, you need not even monitor the trade. Just set alarms at the support and resistance levels and kick back with a good book.

In fact, you'll want a good book in most cases. The only drawback to trading range channels is that it's boring. However, most of us can stand a little boredom given that even a fairly short channel can offer 100+ pips. Furthermore, the channel often ends by breaking in the direction of your open trade, providing a nice little fare-the-well.

Here are some rules for trading channel ranges:

Enter the channel for the first time in the direction of the preceding trend. If the prices were moving in an uptrend before the channel formed, buy at the support. If the prices were moving in a downtrend, sell at the resistance.

Be quick to close your trade when price touches the boundary opposite to the trend. For example, if the pre-existing trend was to the upside, close your sell trade as soon as price touches the support. But wait to be sure you don't have a breakout before closing on the trend side. Price often rests inside a channel before continuing its original trend. In an uptrend, for example, it's good to let the price bounce off resistance and turn around before closing. You'll give back a few pips this way, but if the price breaks through resistance to continue its trend, you'll earn them back plus more.

If you closed too soon, *don't chase the breakout*. You have no way of knowing how far it will go, and you won't be able to choose an appropriate stop. It's a high-risk trade based on greed.

Occasionally the price will turn around without reaching support or resistance. When this happens, you need to let the trade return all the way to 0, because it may be only a mini-retracement. There is no need to lose your spread, of course. Never take an actual loss that you can avoid. Giving back pips is one thing. Taking an unnecessary loss of capital is something else. Always choose to preserve your capital.

Let the trade come to you. Resist the urge to get in early thinking it won't quite touch the boundary. If it fails to touch the boundary, this may be a sign the channel is consolidating or even that you're seeing a channel where none exists. If you take the trade even a few pips early, you're carrying twice the necessary risk. When range channel trading, you never need to risk more than a pip or two beyond your spread.

Always be aware of scheduled news releases. A news release can cause the channel to break unexpectedly and in the opposite direction of your trade.

Sometimes price will consolidate until the candles are only a few pips tall and the channel peters out. The market is getting ready to break. If candle formations imply the break is likely to be in your direction, you may want to keep your trade open. Otherwise, close the trade and wait.

After you close a trade that has extended beyond the boundary, don't open a trade in the opposite direction until price has crossed back into the channel. While it may appear to be moving in the expected direction, don't try to get in too early. There is too much risk that the price will suddenly turn and move quickly in the direction of the trend, causing an unexpected loss.

You can capture a significant number of pips from even a narrow channel, but never trade a channel that's less than 4 times your spread. The channel needs to offer enough potential to justify the risk of trading at all. Also, if the channel is too narrow, it may stall out and become a consolidation. You can't trade a consolidation.

About the only real risk to range channel trading is seeing channels where none exist. When you think you see a channel forming, let the boundaries be tested a few times before you place a trade. Trends bounce off support and resistance levels constantly; don't confuse this with the beginning of a channel. Don't be in too much of a hurry. Channels form frequently and there will be another one soon enough.

You can judge the viability of a channel by how many times price has bounced off support and resistance.

2 times – This is a signal to monitor price for a potential channel formation.

3-4 times – Channel has formed. Trade with minimum lots.

5-6 times – Strong channel. Increase number of lots.

7+ times – Trade maximum lots.

Indications that a channel will have a strong boundary include:

The boundary is on a number that ends in 5 or 0.
The boundary coincides with a pre-established support or resistance.
Price has also channeled in the next longer timeframe.

Look for a range channel to form:

- From a large, steep movement that is retracing. The retracement often turns into a channel while the market rests.

- When the price forms double tops or double bottoms. Market wisdom has it that these signal a reversal in trend. I've found that to be about as reliable as most indicators, but they do often forecast the beginning of a channel.

- During evening hours, after 4 pm EST. While my workday runs from 7 a.m. until noon, if I'm relaxing with a book or television, I often work a channel trade in the evening. Evening channel trades are usually very slow moving, so require little attention.

- Before a major news release and when the market has settled after a major news release.

Oddly enough, a range channel often continues the same distance as the trend before it. I'm talking inches here. You can literally measure it with a ruler. A friend noticed this, and while it doesn't always happen, it happens often enough to be spooky.

You may want to leave a range channel trade working in the background while you trade a different currency pair in the foreground. I usually start my work day by checking through the various currency pairs looking for potential range channel formations.

Some currency pairs are more likely to form range channels. These are the pairs that are strongly correlated; for example, the EUR/CHF. Obviously, the Franc is not going to move strongly opposite of the Euro for an extended time. Consequently, the pair ranges much of the time, and regularly forms channels inside the range. In fact, the EUR/CHF channeled for a full year between 1.5340 and 1.5570 from the first of 2005 until February of 2006.

It's easier to identify channels if you zoom out from the chart and check various timeframes. Obviously, if you day trade, you won't want to consider long timeframes because your trade may not have time to develop. On the other hand, it might be nice to let the EUR/CHF channel in the background for a year.

A case could be made for trading nothing except range channels. They are that safe and reliable. While babysitting a friend's 8-year-old son one day, I kept him entertained by letting him trade a range channel. I only let him trade with dimes, but he went home with six bucks in his pocket and something to brag about to his buddies.

By trading multiple standard lots, you could earn a nice living trading range channels alone, with absolute minimum risk to your capital. The difficulty lies in the self-discipline required to reject other trades, because waiting for a channel to form is often like watching paint dry.

If you need or want to trade conservatively, you might choose to trade other opportunities with minimum or fraction lots, while reserving multiple lot trades for range channels.

Range channels are my bread-and-butter trades. They pay the rent and sometimes fund that portion of my account that I reserve for more risky trading. As you know, Forex can behave like a dragon with an attitude problem. But even dragons sleep. When the Forex dragon sleeps, it goes into a channel. And when it channels, you can slip in and steal the gold.

An important caveat: there is a trading strategy called "range trading." It is not the same thing as range channel trading. Range trading involves incremental buying and holding in a position opposite of the market with the intention of earning profit when the market reverses. It's extremely risky and requires deep pockets, not to mention nerves of steel. With range channel trading, you are buying and selling at support and resistance with minimal risk.

One final note: support and resistance boundaries are guides, not indicators. They aren't carved in stone and shouldn't be used in place of a feel for price movement, in the way you might use an oscillator. I often adjust my S&R lines a couple of times during the life of a channel.

Maybe you've read one the excellent trend-trading books. Trend trading sounds great because it's simple and fail-proof. Sort of.

If you've tried it, you may have noticed a few shortcomings. Such as the fact that you're often not sure where to get in and never know when to get out. Or that you don't have the staying power, not to mention the nerve, to withstand 20+ pip retracements. Or that by the time you realize the retracement is actually a change in trend, you've lost more than you earned last month.

Maybe you decided to try going for short-term mini-trends, better known as movements, which lend themselves to scalping. You figured you'd be risking less and could get out quick. If so, you no doubt experienced the joy of repeatedly buying at the top and selling at the bottom.

Eventually you may have decided that trend trading is for the Warren Buffet's of the world, dedicated to investing, not trading.

However, there is a reasonably safe way to trade the trend. Trends form channels, too.

Unfortunately, trend channels are not as reliable, precise, or easy to identify as range channels. However, they have the virtue of more frequently breaking in the direction of the previous trend, as you can see from this example. Consequently, although it's often more difficult to know when the channel will break, you will usually have an open trade in the right direction.

To position yourself for taking advantage of the break, you need to always allow price to bounce off and retrace from the boundary that corresponds to the previous trend – resistance if it was in an uptrend or support if it was in a downtrend. Higher than normal volume at the boundary indicates a break may be imminent.

There are a couple rules-of-thumb to help you prognosticate break behavior:

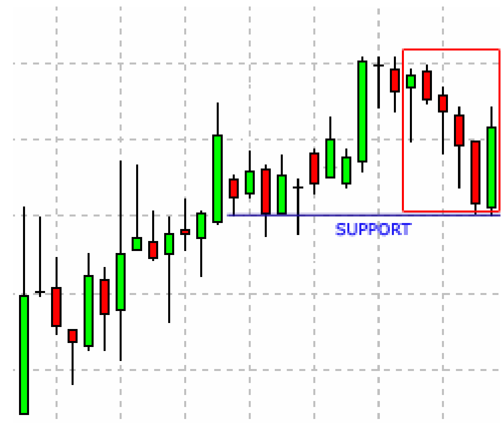
- If volume is high when the boundary is broken, but then the volume quickly drops, price will probably return to the channel or just beyond it. Take your profit early.

- If volume is unchanged or low when the boundary is broken, but then increases, hold on to your trade until the movement has clearly stopped or turned around. Price will usually not return to the channel.

Many of the most reliable trend channels are formed from the retracement of a long-term trend. Check longer timeframes to see if this appears to be the case. If it is, you can get a good idea of where the channel will break.

For example:

This is the same 15-minute chart referenced above.



This is a 1-hour chart. The red square in the upper right corner is the movement shown on the 15-minute chart.

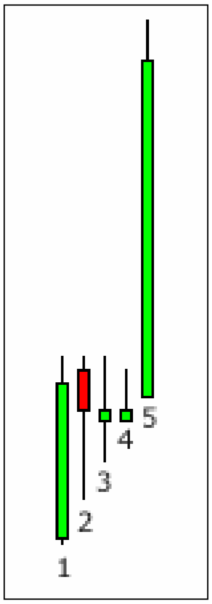
As you can see, price was in a long-term uptrend. At a certain point it retraced, and the retracement created the channel on the 15-minute chart.

The retracement ended at the minor support boundary on the hour chart. As soon as price bounced off that support, you could feel certain that it would resume its uptrend, causing the 15-minute channel to break to the upside.

Most traders have a preferred timeframe from which they place most of their trades. But even if you trade exclusively from one timeframe, you need to study multiple timeframes to get the full picture. If you study only one timeframe, you can see only a small fragment of the whole; in effect you're flying blind. I trade the 15-minute chart, but routinely reference the 1-hour and 4-hour charts. Sometimes I look at a 5-minute chart as well. And I always study the day chart before I begin trading any currency. You need to really study the charts, zoom in and out, find support and resistance, and analyze the candles.

I recently read a commentary in which a highly-placed expert repeatedly insisted the dollar was significantly oversold against the Euro and was due for a huge rally at any moment. And yet, a quick glance at the daily chart revealed that the Euro wasn't anywhere near the previous peak of only a few months before. It had plenty of room to continue the trend before reaching any significant resistance. And in fact, that's exactly what it did. Perhaps his favorite oscillator, or the 200-day moving average, or some other computer-generated wizard informed him the dollar was oversold. But price said the Euro had lots of room to grow.

Unlike indicators, candlestick formations often reveal where the market will go because they model actual price. This chart shows a typical breakout formation. Let's analyze it step-by-step.

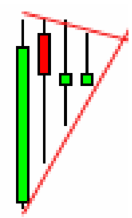


1. This candle is displaying good bull energy. It's a fairly long candle and the upper shadow is longer than the shadow at the bottom. This indicates the price is testing toward the top.

2. Don't be fooled by the color of this candle. In fact, it's a strong bull candle. It tested down with the long bottom shadow, but never reached the low of the candle before it, and the price traveled back up to close fairly near the top.

3. At first glance, this candle appears to be a neutral signal, with the open and close near each other and the shadows nearly the same length. In fact, it's the first candle that forecasts a break to the top. Notice that its bottom shadow is again higher than the candle before it and the top shadow has reached all the way to the top of the candles preceding it. The doji effect which makes the candle first appear neutral is simply a mini-consolidation before the break.

4. This candle confirms a break to the top. At this point the candles have formed a triangle with the bottom sloping upward. Price is consistently moving up *and* testing up. This candle has no bottom shadow at all. This is a strong indication, given the pattern made by the preceding candles, that the price is ready to break and will break upward.



You should enter this trade when the price reaches one pip above the high of candle #3, which has been the highest price in the formation. Your stop would have been one pip below the low of candle #4. Do you see why you would have placed your stop here? You've made your trade based on a formation that consistently produced higher lows. If the price fell one pip below candle #4, the pattern would be broken. Your reason for being in the trade would no longer apply.

Set stops according to your reason for being in the trade (price), not according to some unrelated formula such as percentage of equity. If setting the stop according to your reason for the trade forces you to accept too much risk, don't take the trade, trade fewer lots, or trade a fraction of a lot. Always choose stops that let you know unequivocally that your reason for being in the trade no longer exists. Any trade that does not provide a clear, absolute stop which indicates the trade has failed to perform properly is a trade you shouldn't take.

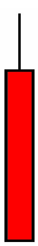
Performance should be your only criterion. It doesn't matter what you think in the heat of the moment because experience tells us that sometimes a trade turns around and sometimes it only gets worse. You should always know precisely what a trade needs to do in order to meet your expectations, and immediately terminate those that fail to perform properly.

Since candlesticks are of Japanese origin, I guess books on candlestick formations can't help but be zen-ish. I've found all those complicated candlestick patterns with the cutesy names to be about as useful as the ADX. In other words, as good as flipping a coin.

However, an individual candlestick *as it forms* does reveal the psychology of the market, and the reading is sometimes strengthened or confirmed by recent preceding candles. Obviously, a candle that shoots straight up tells a different story from a candle that travels up, then down, first green, then red, to close exactly where it opened. And that story is vitally important.

The problem happens when traders try to look at a group of already-formed candles to foretell the future by the pattern they make – not unlike, and probably about as useful as, reading tea leaves. If you've been watching the candles as they form, the pattern created by preceding candles can furnish a reminder, a visual note to yourself, of what price has been doing during the past x increments of time, in relation to what it is doing at the current moment in time. But the most vital information is not in some pattern the candles have created, but in the rhythm of the movement as the candle forms.

Most traders give their attention primarily to the candle body, especially whether it is a red (bear) candle or green (bull) candle. But in fact, it's the shadows that provide the most useful and reliable information, with color sometimes providing confirmation and sometimes being irrelevant.



For example, the shadow of this candle completely neutralizes the color. It's a bull candle, even though it is red.

This candle is called "Closing Marubozu." I don't remember what Marubozu means. I remember this is considered a "weak line." But I don't know what that means, either.

What I *do* know is that price opened, tested up (forming the upper shadow), then closed down. *But it never tested below the close.* That's the vitally important part. It tells you that while the market is backing off slightly, it has no real inclination to move down. In fact, it implies that it's likely to move up.

When this candle appears during an uptrend, many bull traders become nervous, believing it signifies a possible end to the movement, or at best a retracement. In fact, the candle itself is a mini-retracement of sorts. You could think of it as the trend pausing for breath before continuing on its way.

When it appears in a downtrend, many traders believe it is just another bear candle among many. But it's not. Price is testing upward. Even if it's not holding up there, it slows the momentum. You can expect the price to move sideways for a little time, or enter a retracement. It may even reverse the trend, with the opening price of this candle determining the new support boundary.

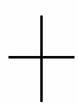
You don't have to memorize candle formations to understand what a candle is telling you. In fact, you're better off *not* memorizing them. Simply watch the candle as it forms and think about what the price movement is telling you. With practise and experience, you'll learn to read the subtle psychology revealed as the image of a single candle forms, and to understand how it is verified, confirmed, altered, or modified in relation to and with the candles preceding it.

Here are a few tips regarding shadows:

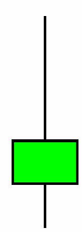
- A long shadow on one end with no shadow on the other end tells you price is testing in one direction but has no interest in moving beyond the end of the candle in the other direction.

- A candle with short equal shadows on both ends can be considered neutral. It often implies that price will move sideways, at least for the next candle or two.

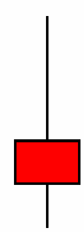
- A candle with long shadows on each end indicates indecision. The smaller the body in relation to the shadows, the greater the indecision. The position of the body – whether more toward the upper shadow or more toward the lower shadow – modifies the indecision somewhat, and this modification is strengthened if the color of the body coincides with its position in relation to the shadow.



This candle, called a "doji" represents neutral indecision because the open and close is positioned squarely in the middle. The market is influenced equally by bulls and bears.



This variation of the doji implies the market is leaning slightly to the downside because the body is somewhat below center.



This variation more strongly implies a downside orientation because in addition to the body being below center, the close is lower than the open.

Candlesticks are useful because they provide a visual representation of price movement. The danger lies in misusing them as a kind of esoteric indicator. While I can show you a picture of a doji and tell you its implications, no one can tell you what the doji *means* because it can have meaning only in relation to the current market. (Jeeze, now *I'm* beginning to sound zen-ish.)

A long lower shadow can indicate the market is interested in testing to the downside. But if the lower shadow ends higher than the candle preceding it in an uptrend, it can equally indicate strengthening of the trend.

While all this may sound so contradictory as to be useless, in reality candlesticks are vital to successful trading. But only if you observe how they develop – the rhythm as well as the formation – and view them as a visual representation of price movement. If you approach them as "Oh, here's a Reverse Harami Pattern so I ought to sell," you may as well revert to the MacD.

In addition to multiple timeframes, it's very helpful to reference the chart of an inversely correlated currency pair.

When I'm trading the EUR/USD, three-quarters of my screen is devoted to the Euro chart and the other quarter holds a small chart of the USD/CHF. I don't trade the USD/CHF, but I follow it closely and track its S&R because it correlates almost perfectly with the EUR/USD, forecasting or verifying breakouts, retracements, and changes in trend. This is another instance of focusing on price as the only truly reliable indicator.

Place two inversely correlated charts side-by-side and observe the price movement. You'll quickly see the relationship and get a feel for timing between the movements of the two pairs.

Here is how some major currency pairs inversely correlate:

EUR/USD	USD/CHF	96%
USD/JPY	EUR/CHF	92%
GBP/USD	USD/CHF	95%
AUD/USD	USD/CHF	95%
USD/CAD	AUD/USD	95%
NZD/USD	USD/CAD	86%

Understand that this is *inverse* correlation. That is, price will move in the opposite direction; i.e., when the EUR/USD is moving up, the USD/CHF will move down.

Some traders like to hold open positions on more than one currency pair in an effort to minimize risk. But if you choose to trade more than one pair at a time, realize that if the currencies are strongly correlated – inversely or directly – you're not spreading your risk. You may as well open one large position with either pair and give it your full attention.

Obviously, all the major currency pairs will have fairly high correlation. Here are some of the least correlating major pairs.

EUR/USD	EUR/JPY	0%	
USD/JPY	EUR/JPY	52%	+
GBP/USD	EUR/JPY	12%	+
AUD/USD	USD/CHF	42%	+
USD/CAD	USD/CHF	16%	-
NZD/USD	EUR/JPY	35%	+

The plus indicates direct correlation and the minus indicates inverse correlation.

Currency pairs that have less than 10% correlation include EUR/USD-EUR/JPY; USD/SEK-EUR/JPY; AUD/CAD-USD/CHF; EUR/JPY-GBP/USD; EUR/CHF-GBP/USD;

EUR/AUD-USD/JPY; and EUR/NOK-USD/CAD. These pairs are appropriate to consider for the purpose of spreading risk.

Currency correlation is an additional part of the picture, and just like multiple timeframes, if you don't study and monitor them, you're flying blind. However, correlation changes in various timeframes. The correlations given here are for short-term trading, assuming you won't hold a trade more than a few days at most.

Correlation also changes due to other factors, such as economic decisions and political events. It's a good idea to regularly update correlations of the pairs you most often trade. A monthly update is usually adequate, unless there have been major economic or political events.

In addition to forecasting price movement, correlation provides two important tools which you can use to maximize profit and protect yourself from loss.

As you can see from studying the correlations, the EUR/USD and USD/CHF move in opposite directions nearly 100% of the time. If you have an open trade in both these pairs, in effect you have no position at all.

However, the pip value of the EUR/USD is $10, while the pip value of the USD/CHF is only $8.06. Consequently, you can use the USD/CHF to hedge your EUR/USD trade.

For example, if you've bought the EUR/USD and you're down 10 pips, you are -$100. But if you also bought the USD/CHF, it is at +$80.60, for a net of -$19.40. This is a useful strategy when you want to take a trade that has potential drawdowns or volatility beyond your acceptable risk limit, for example when trading the news.

According to my own trading rules regarding risk, I have no business trading the news. Alas, I'm only human. I trade it, and I bet you trade it, too. But I would never trade it without the safety net of hedging. While it's true that hedging takes some of your profit, unless you are suicidal it's not the quick spurt you're after, but those beautiful long candles that shoot straight up the chart, one after the other. You have plenty of time to close out the losing position after you're certain the market is committed to the direction of the move. In the meantime, those quick spurts up and down won't eat your lunch.

Of course, you could hedge by buying and selling equal lots of one pair, assuming your dealer allows this, but you would be unnecessarily reducing your profit if the trade goes in your direction. If your buy goes up 20 pips and you hedged with the same pair, you're still at 0. But if you hedged using correlated pairs as in the example above, you're at +$38.80.

Notice that in this example, $38.80 is about what you would have gained if you'd been trading a couple of mini lots. You can use hedging in this way to quickly increase your position in a trade. You can hedge yourself down to a mini position until you're sure of the trade, then jump to a standard simply by closing your hedge trade.

If you trade a mini account, you can use the same strategy to, in effect, trade micro lots, providing yourself with a great deal more flexibility for the purpose of money management.

Many traders make the mistake of always trading the same number of lots. This is to believe that every trade carries the same amount of risk, which obviously is not the case. If, for example, the optimum stop according to price movement is twice as far as your risk parameters will allow, you could choose not to take the trade. But you could also choose to trade half the usual number of lots, or to hedge for the purpose of creating a fraction of a lot. The one thing you should *never* do is place your stop according to irrelevant criteria, such as how nervous you feel or some percentage of your equity. Stops must always be placed according to price movement alone, recognizing that placing no trade at all is always an option.

Stop placement is not the only measure of risk. Volatility is equally important. But don't rely on an indicator to measure volatility. If you've been paying attention to price movement, you'll have a better feel for current volatility than any indicator can provide from manipulated historical data. Trading the same number of lots in a volatile as in a sedate market is just plain crazy. You're accepting too much risk on the downside and limiting your potential on the upside, creating a classic can't-win situation.

Currency correlation can also be used to minimize risk in fundamental trading. For example, suppose you believe the USD will generally under-perform in relation to the other major currencies. In other words, you are bearish regarding the dollar.

You could buy two lots of the EUR/USD. But you could also buy one lot of the EUR/USD and one lot of another, lesser correlated, USD pair – such as the USD/CAD. The difference in correlation will provide some protection, and the fact that Europe and Canada are not subject to the same monetary policies and political pressures will add to that protection.

Successful trading involves money management – it's not something to tack on to the end of a treatise about some super-system. It's an inherent part of trading, as important as entry, exit, limit and stop.

A guru recently shared his instructions for trading the news: just wait for a consolidation before a big number is released, then trade the breakout.

I read this remark to my trading buddy, who said, "I wonder how many times he's done that." I answered, "Once. Now he's a commentator because he can no longer afford to trade."

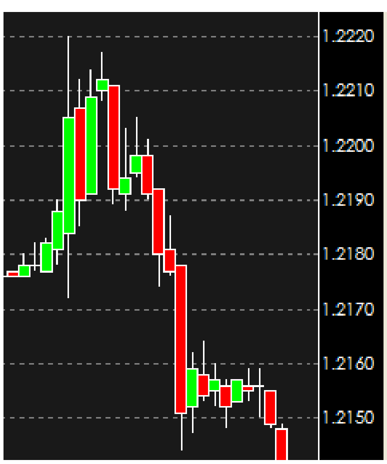
Lots of traders know nothing about the news reports they trade. Some don't even know what all those initials actually stand for. If you ask them, they'll say they don't worry about fundamentals because "it's already in there."

Hardly.

While it's not necessary to become an economist, if you intend to trade the Forex professionally, you need to know something about the business you're in. At the very least, you need to know the major U.S. reports, when they are typically released, and how they affect the market value of the dollar.

To trade the news successfully, you must have an expectation of where the market will go. If you simply jump in for the ride blind, you'll likely get shaken out when price shoots up, then down, then back up again. In the nightmare scenario of the unprepared amateur, the price shoots up, you buy; it drops, you sell; it turns around, you buy again, etc.

In addition, price often "gaps" in response to news. Even if you have a stop loss in place, the price can jump dozens of pips beyond, never touching your stop. By the time your stop is filled, you may have lost hundreds of dollars.



This is a one-minute chart showing market response to the Non-farm Payroll report. The moment the news was released, the price dropped from 1.2190 down to 1.2172. Many new traders probably stopped out, believing the trade was going against them.

But in fact, the price immediately shot up from 1.2172 to 1.2220 – a gain of 48 pips. This happened within the course of only 60 seconds. Most new traders would have become over-excited near the top and placed a buy. The price then promptly dropped to 1.2185, for a loss of 35 pips. Again, the new trader would have stopped out. But as you can see, the price turned around again, moving up to 1.2217, then back down to 1.2189.

When the dust settled, the price stabilized 13 points below its original value. In the meantime, within approximately 5 minutes, the new trader could have lost 100+ pips.

In this kind of volatility, even experienced traders often lose.

Some dealers are notorious for "slippage" on news trades. Others raise the spread during times of high volatility. Obviously, the latter is to be preferred, but in either case, trading the news is both expensive and risky.

That's why, if you're going to trade the news, you need to be informed enough to have an opinion regarding how the market is going to react. Rather than waiting for the market to move and trading the breakout as our expert suggested, you need to have your position open, your worst-case stop loss in place, and your hedge trade established. If you have no idea which way the market will move, you have no business trading. And just in case you don't yet know this: the prognostication of experts is often wrong. You need to form your own opinion.

If your dealer is one of those that increase the spread during high volatility, taking your position early has the further virtue of allowing you to enter with the best spread.

Interest rate change has the strongest effect on the market. Rate of inflation is vital because the primary way to fight inflation is to raise interest rates. A rise in interest rates will move the local currency higher.

In addition to interest rates, there are core news releases that you need to be particularly aware of because they almost always move the market significantly. These include:

GNP (Gross National Product)
GDP (Gross Domestic Product)
PPI (Producer Price Index)
CPI (Consumer Price Index)
PMI (Purchasing Manager's Index)
Durable Goods
CRB Index (Commodity Research Bureau Futures Index)
ECI (Employment Cost Index)
JoC Index (Journal of Commerce Industrial Price Index)
Leading Indicators
Consumer Sentiment
Housing Starts
Retail Sales
Automobile Sales
Nonfarm Payrolls
Manufacturing Payrolls
Unemployment Rate

Some traders keep themselves well-informed, become experts at hedging, and trade nothing but the news. Certainly that's when the adrenalin flows, the high-drama happens, and serious money is won or lost. The average response to news for the EUR/USD is said to be 56 pips during the first 20 minutes. I consider that a fairly conservative estimate.

It's a rare week that doesn't include a couple of major news releases. Few traders can resist the temptation to trade the news. Be sure to check for major support and resistance on the daily chart and understand that no indicator – not even the 200-day Moving Average – can forecast market response to the news. Only an ongoing understanding of the economic reports and their likely effect on the market, good hedging skills, and nerves of steel can help you trade the news.

The real boogey-man in Forex isn't a moving average crossover that doesn't work. The real boogey-man lives inside your head and he has all the charms of Freddy Krueger.

It seems logical to think the guy making a $100,000+ trade is under a lot more pressure than the person trading three lots on a mini-account. In fact, the opposite is more likely to be true. The former usually has more resources and more experience and can withstand greater drawdowns. The mini-account trader can get wiped out quicker and one relatively small loss may determine whether or not he lives to trade another day.

Everyone knows better than to trade with the rent money. And yet, it doesn't take long hanging around the forums before you hear a tale of woe from some schmuck who not only lost the rent money, but also the money he borrowed from his brother-in-law and the money he got from pawning his wife's engagement ring.

Most of us won't go that far. But the advice to only trade with money you can afford to lose is specious. The reality is that most of us don't have *any* money we can afford to lose.

The trading method explained in this document works. I'm sure it's not the only method that works, but I'm equally sure it has a lot in common with all methods that work. It's not particularly sophisticated. In fact, it's simple. But simple is not the same as simplistic.

As simple as it is, you'll still find ways to derail yourself.

> You'll convince yourself a channel exists when it doesn't. Or you'll trade a channel that's too narrow, losing your spread when it goes into consolidation.
>
> You'll second-guess your trade, be tempted to go out with a small win or loss when the candles keep moving in the wrong direction, become convinced you're going to lose when the ticks slow to the speed of cold molasses.
>
> You'll be tempted to take trades after they've moved off the boundary because you "know" it's going to turn around.
>
> You'll want to buy high or sell low, gambling on a big breakout.

And you'll probably think of other foolish moves that haven't yet occurred to me or that I'm too embarrassed to mention.

Everyone talks about the risks associated with fear and greed. But I would add a third, even greater risk: boredom. If you came to the Forex for high excitement, you've come to the right place. You'll get all the adrenalin you can handle, and then some. However, Forex is high-priced entertainment. It would be much less expensive, and arguably less dangerous, to take up bungee jumping.

Successful trading is boring much of the time. Range channel trading is *very* boring. A really good channel may occur only a few times a week. In the meantime, you'll be sitting around staring at the computer screen, watching other people make money. (You're also watching other people lose money, but you won't think of that when the market moves 80 pips. One thing that helps is to remember that a big movement is often followed by a long channel.)

Even an open trade isn't particularly exciting when you're trading the channel. After all, you pretty much know what's going to happen. The only question is whether it might break out in the direction of the trend. Sure, it will occasionally take an unexpected dive, but your stops are so tight that you won't have enough exposure to trigger adrenalin flow. In addition, channels are slow-moving by nature.

To trade Forex successfully, first of all you need to be very clear about why you are trading. Some people trade for entertainment, like going to the track or visiting Vegas twice a year. Okay, that's valid. Forex is particularly dangerous if you happen to have a gambling problem because of its accessibility, but you're an adult and can make your own choices in life.

However, if you're trading Forex for earnings -- and in particular if you are trying to earn a living from it -- you need to approach it very differently from the person seeking entertainment. Earning a living from Forex isn't particularly difficult once you understand how it's done. It's not complicated. It is possibly the most boring job in the world. I can't emphasize this enough because if it isn't boring most of the time, you're gambling, not trading.

To trade successfully, you need the mindset of a cat stalking a mouse hole. What do cats think about all that time? I wish I knew.

There is one absolutely reliable, never-fail law of Forex. I'll share it with you: after waiting three hours for a trade setup, if you run down the street to grab some takeout real quick, you'll return to find the trade happened while you were gone. Not only that, but it will have been a perfectly beautiful setup – the best you've ever seen. In fact, this law is so reliable that if you have a friend who trades Forex, when you become really desperate you can take turns triggering it for each other.

The greatest danger in channel trading – the trap everyone falls for at least once and some of us fall for every time – is the urge to chase a breakout. Those beautiful long candles rushing straight up (or down) are so hard to resist. But if you want to take a profit at the end of the week, you must be strong. Never chase a breakout. Ride a breakout with abandon when it occurs naturally -- that is, in the direction of your already open trade. But never, never, never open a trade for a breakout. It will take hours, possibly days to regain the loss you will almost invariable incur. (Yes, I know it moved 50 pips beyond when you wanted to get in. But that's only because you didn't do it. If you had done it, the 50 pips would have gone against you instead. If you don't believe me, just try it.)

Those huge, fast movements are almost always caused by big players placing or closing trades. When the movement stops – and it can stop at any second – the market will either stall or, more often, immediately retrace to within a few pips of the start of the movement. In other words, as soon as you take the bait, the trap will spring and you are lunch.

Wait for the market to settle back into another channel, and carry on quietly collecting your modest gains. At the end of the week, you'll come out ahead. And sometimes you'll have an open trade in the direction of one of those delectable spurts. Hang on and enjoy the ride.

Worthless Market Wisdom

I used to be intimidated by market gurus and experts. That's before I lost most of money following their advice. Here are few of the tidbits that are completely worthless. Follow them at your own risk.

Cut your losses short and let your profits run.

This sounds like it ought to be true, but without context, it's dangerous nonsense. Cutting your losses short will result in taking lots of unnecessary small losses, which soon add up to a big loss. Not only do you lose real money, but you lose the opportunity to gain profit when the action stops you out, then promptly turns and goes in your direction.

The other side of the equation – let your profits run – only underscores the irrationality of this concept. The claim is that lots of small losses can be ignored, despite the fact that they soon add up to disaster – and lots of small wins should *also* be distained, despite the fact that they soon add up to a nice pile of pips. Also to be ignored is the painful fact that a profit taken too late often turns a win into a loss as you give back the pips you'd gained.

The theory behind all this is that your few big wins will more than counterbalance your many small losses. But the fact is that you can't go wrong if you win almost every trade and your market-based stops are reasonably tight.

What is a "small" win? Less than 20 pips? Less than 10? The concept is so relative that it's meaningless. If I gain 10 pips but I'm trading 5 lots on a standard, I've just earned $500 – usually in a matter of minutes.

In real life, the "cut your losses short and let your profits run" strategy will result in lots of small losses, lots of returned profit after closing at zero or taking more small losses, and an occasional "big" win that you are unlikely to ride out because you are now a nervous wreck from racking up so many "small" losses.

In a strong and reliable channel, you can earn thousands of dollars in only a few hours by taking many small but certain wins. It's actually possible to work for 4 hours, making dozens of small trades and *never once taking a loss,* stopping only when the channel is broken, giving you a nice fat win in the final trade with which to finish your session.

Set your stops to 2% (or some other arbitrary number) of your principle.

Understand this: the market neither knows nor cares how much money you have. Set your stop according to support and resistance. If you can't afford the trade, don't take it. Wait for an opportunity where support or resistance is within reason. Unless you want to lose your money, never use any criterion other than price movement for setting stops.

The trend is your friend.

You don't have any friends in this business. You don't have any enemies either. It's not war, it's not personal, it's not a zero-sum game in any way that you need to worry about.

If you want to view Forex as a big video game in which the bad guys are out to take your money, then by all means, invest in multiple monitors littered with complicated indicators, then spend your time back-testing trading systems and hanging out in the forums. You can even choose a user name that includes the word "cowboy." That's entertainment. Personally, I prefer an evening of live theatre followed by dinner, but to each his own.

If you channel trade, you'll be trading against the trend 50% of the time and I assure you, the money you will earn is indistinguishable from money earned trading with the trend. What goes up will come down – often at an inopportune moment – and there's nothing sacrosanct about a trend.

Take your profit out of the middle.

The idea here is to avoid the risk of trying to pick tops and bottoms. Don't be greedy. Just play it safe and take a reasonable profit from the middle of the movement.

You'd like to do that, wouldn't you? Me too. There's just one problem. To identify the middle, you need two ends. In other words, you never know where the middle is until it's too late to make your trade. Any tick could be the tick that reverses the trend.

One final note:

The trading method presented here works. It works because it is not a system based on indicators, but a method of trading based on true market value, or price. It works in all currencies, in bear markets and bull markets, in all time frames.

However, it's not exciting and it's not always easy. Consequently, I expect most people to read this document, appreciate the logic of it, and proceed to ignore it. Human nature is like that. We want the easy solution, the magic bullet. That's why we spend billions on expensive and dangerous pills when we want to lose weight.

That's okay. Just put it aside for the day when you've lost too much money and endured too much pain. Then pull it out and read it again.

We've been taught to turn to established experts for advice, and certainly this makes sense when we're dealing with, for example, health or legal issues. But in many endeavors – and Forex is one – the established experts are not operating from your reality. They may never have operated from your reality. Most Forex experts learned in a professional environment with experienced mentors to train and supervise them while trading a virtually limitless account containing someone else's money. They didn't learn Forex sitting in their family room trading on a laptop with money they probably ought to apply to their kid's college fund.

You and I are operating from a different reality. We don't have the luxury of shrugging off *any* loss. We should consistently strive for 100% wins. We must never place a trade unless we are absolutely certain it will be profitable.

Naturally, we'll lose on some of our trades despite our well-founded expectations. One truism of Forex is that the market can remain irrational longer than you can remain solvent. You can read that and laugh ruefully, but you better never believe it. When you lose on a trade it's for one reason: you made a mistake. Identify that mistake, learn from it, and try to avoid it in the future.

You've heard a thousand times that the leading cause of failure in Forex is undercapitalization. But you can succeed at Forex starting with a minimally-funded mini account. In fact, depending on your personal psychology, you may actually learn faster if you start with less money, because you don't have the luxury of making wild trades.

The leading cause of failure in Forex is overtrading, defined as taking inappropriate trades or trading beyond your skill level.

Forex attracts a certain kind of person. Let's just call him a wannabe high-roller. Some few will in fact eventually become high-rollers. But most will ultimately fail.

The reason they fail will not be undercapitalization. In fact, many will fund their accounts repeatedly, eventually losing tens or even hundreds of thousands of dollars in an effort to keep the dream alive.

The reason they will fail is because they repeatedly lose on trades they had no business making in the first place.

Be very clear about your reason for trading Forex. If you're trading for excitement and you're willing to pay the price, then go for it. But if you're trading to earn money, you can't afford to take anything except a high-probability, low-risk trade. These trades are rarely exciting.

Just remember this: if you approach Forex as a gamble, know up-front that the house odds would make a Vegas Pit Boss blush.

The Best-Kept Secret in Forex

To new traders – and many experienced traders, as well – Forex seems complicated, sophisticated, best suited to financial institutions and savvy billionaires. In fact, part of the attraction for many traders is the fantasy of winning against the big boys in a rich-man's game. These are the guys who trade with multiple monitors loaded with dozens of indicators and are either trading, talking about trading, or thinking about trading nearly 24 hours a day.

But there is another kind of individual trading the Forex. This person often trades on a laptop, working a few hours a day. The rest of the time, they are focused on something else – maybe traveling through Europe or writing the Great American Novel or spending time with their kids.

For these people, Forex is a job, not a way of life. They trade from simple charts according to a few basic rules learned from experience. They rely on elementary, fail-proof trades and smart money management, rather than complicated, convoluted strategies. They have a fair understanding of the major economic reports, and they avoid the kind of high-risk trading associated with trading the news by jumping in and hanging on.

In fact, they carefully avoid all forms of high-risk trading. Their number one trading rule is to take only high-probability, low-risk trades. Most of their trading day is spent sitting on their hands. Consequently, while few may be card-carrying members of the billionaire's club, they earn a higher-than-average income while enjoying a lifestyle most people can only dream about.

You may run into one, using wi-fi to trade at a coffee house in Brussels. If you ask him, he may tell you that Forex is one of the most boring jobs in the world, but Brussels is grand.

Psychology is Everything

New traders want a magic bullet, which they mistakenly refer to as a "trading strategy." Most Forex books promote the author's hot new and/or "secret" system, incorporating a variety of tweaked indicators, the more complicated the better. Few Forex books talk about psychology beyond vague platitudes about fear and greed.

In Forex, psychology is the name of the game.

When you begin to trade Forex, you come face-to-face with… yourself. You will fail to take an excellent trade because your self-confidence went south with your last three trades. You will jump on an inappropriate trade because the candles are shooting straight up. You will wait for that extra pip of profit until the market turns around and takes back everything you earned. You'll move your stop because you just know the price is going to turn around any second now.

You'll increase your number of lots to make up your losses more quickly. You'll pyramid as the price moves against you, sure you'll make a fortune when it turns around. As your number of losses mount, you'll make wild trades because it's time for your luck to change. Or you'll sit there frozen, afraid to do anything because you know whatever you do will be wrong.

You'll trade because you're bored and what's a few pips more or less? You'll trade because it's Thursday and you have only a third of your goal for the week. You'll trade because all the experts agree the news will be good. You'll trade because … trading is fun.

And you'll go broke. You won't go broke because you didn't have a good system. You'll go broke because you didn't understand the psychology of the market, and more importantly, the psychology of *you.*

There is no holy-grail system, but even if there were, traders would still go broke. In the modern world, money determines our status and security. When it comes to issues as fundamental as these, responding rationally instead of emotionally requires a great deal of insight and self-control.

However, anyone with common sense and a bit of self-honesty can make a decent living with Forex. If you're new to Forex, or you've never consistently made money before, don't start with hedging and trading the news. Begin trading Range Channels and work your way up as you gain experience, confidence, and money. If you can't resist the temptation to overtrade – which means trading beyond your skill level as well as taking inappropriate trades – you won't succeed in the long run.

Forget the indicators and the systems and all the get-rich-quick shortcuts. Focus on price, use support and resistance, provide a clear mind to carefully study what the market is teaching you, and develop your skills rationally. In other words, KISS (Keep It Simple, Stupid). You'll earn money immediately, and you'll earn money consistently, and you just might get rich quick after all.

Happy Trading.

No-Fail Forex started out as notes I was sharing with my trading buddies. Now it's become like a little No-Fault Forex cult thing and I receive emails from people I've never heard of wanting a copy.

Over time, I've received feedback and questions, and while I'm always happy to hear from other traders — especially those who are trading price — there's one thing I want to address here because so many people seem to have a problem with it.

Too many people try to approach the No-Fail method as if it were just another system. For example, one person asked me to show them, on the range channel chart, exactly where I would enter and exit.

That's impossible to do, because you would decide exactly where to enter and exit according to, among other things, volatility and volume. You need to focus your attention on what price is doing in order to trade according to price. Support and resistance lines are not just a different visual representation of an oscillating indicator.

In addition to what you're seeing with price movement, candle formation, etc., you need to develop a feel for the rhythm of the market at the time of your trade. Sit back, relax, watch how the candles form, look at how price is moving in relation to S&R, get a feel for the rhythm of the movement.

Are the candles making strong forms, or are they retracing themselves repeatedly? Obviously, a candle that opens, shoots up 6 pips, and closes is telling you something different from a candle that opens, shoots up 6 pips, then down 8 pips, then back up 4 pips to close.

Forex is not 100% left-brain. You can over-analyze your trade. Adjust S&R lines as the trade develops. Set stops in relation to how the candles are forming. Exit according to volume and volatility, not just because price has touched a boundary – that would be no different from trading with a moving average cross. There is nothing static or mindless about Forex and you need to listen and respond to what the market is telling you.

You're not just a robot that mechanically opens and closes trades. You are an active participant in the market. You need to remain flexible and responsive.

Best regards,
Lee