DAY TRADING FOREX WITH PRICE PATTERNS

FOREX TRADING SYSTEM

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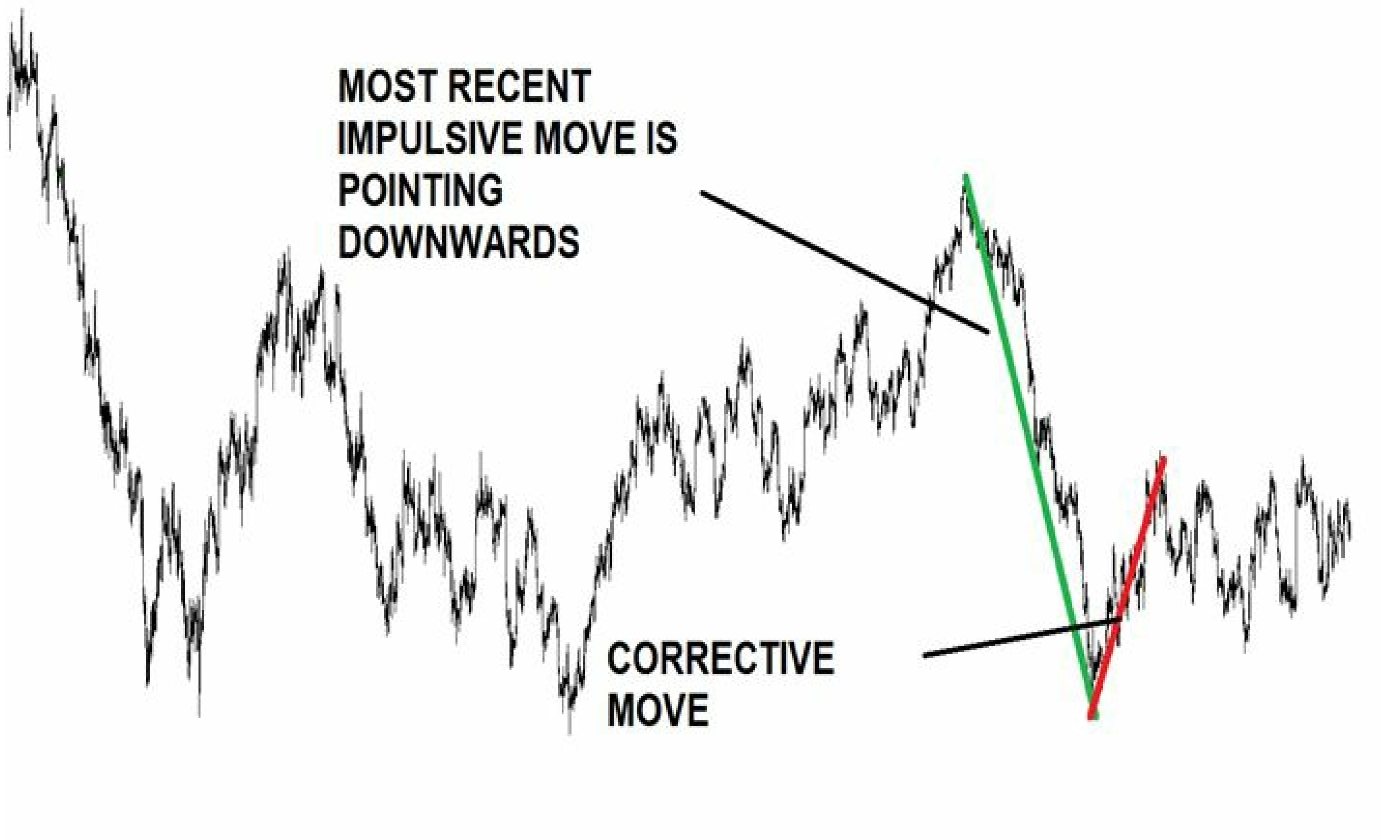
About the system

A very clean and extremely profitable day trading system that does not use technical indicators of any kind, but only concentrates on reading the price action. It focuses first on the bigger picture to find out which of the buyers and sellers are more powerful at any given time and then uses this information for day trading on smaller timeframes with the help of very strong patterns that price makes. This is all you need; this is all this system needs in order to deliver a thousand pips per month or more. Beginner traders often think that for achieving success in the foreign exchange market, they have to invent something, to be unique, to come up with some complicated trading techniques that no one else has thought of before. This is very wrong. Forex is not about uniqueness at all, it is about a very large group of people buying or selling at the same time. The more people that buy or sell at a given level of price, the greater are the chances of success. If you develop a unique strategy and then start to buy or sell according to it, the levels of price where you buy/sell will be overlooked by the majority of traders out there, they will not do the same thing you did because they don't know your unique system, and they don't base trading decisions on it. In conclusion, you always have to go with the crowd not against it; the more obvious and well known things are by the people out there, the greater the chances of success. This is in part what makes this trading system very profitable, it works with very clear, very popular and easily identifiable price patterns. Being very popular, most traders watch them closely and trade them when they finally break. Another important part that makes this system profitable is trade management techniques, knowing how to set and trail manually your stop loss levels in order to obtain the maximum from every trade. All of this being said, let us go deeper into the components of this trading system.

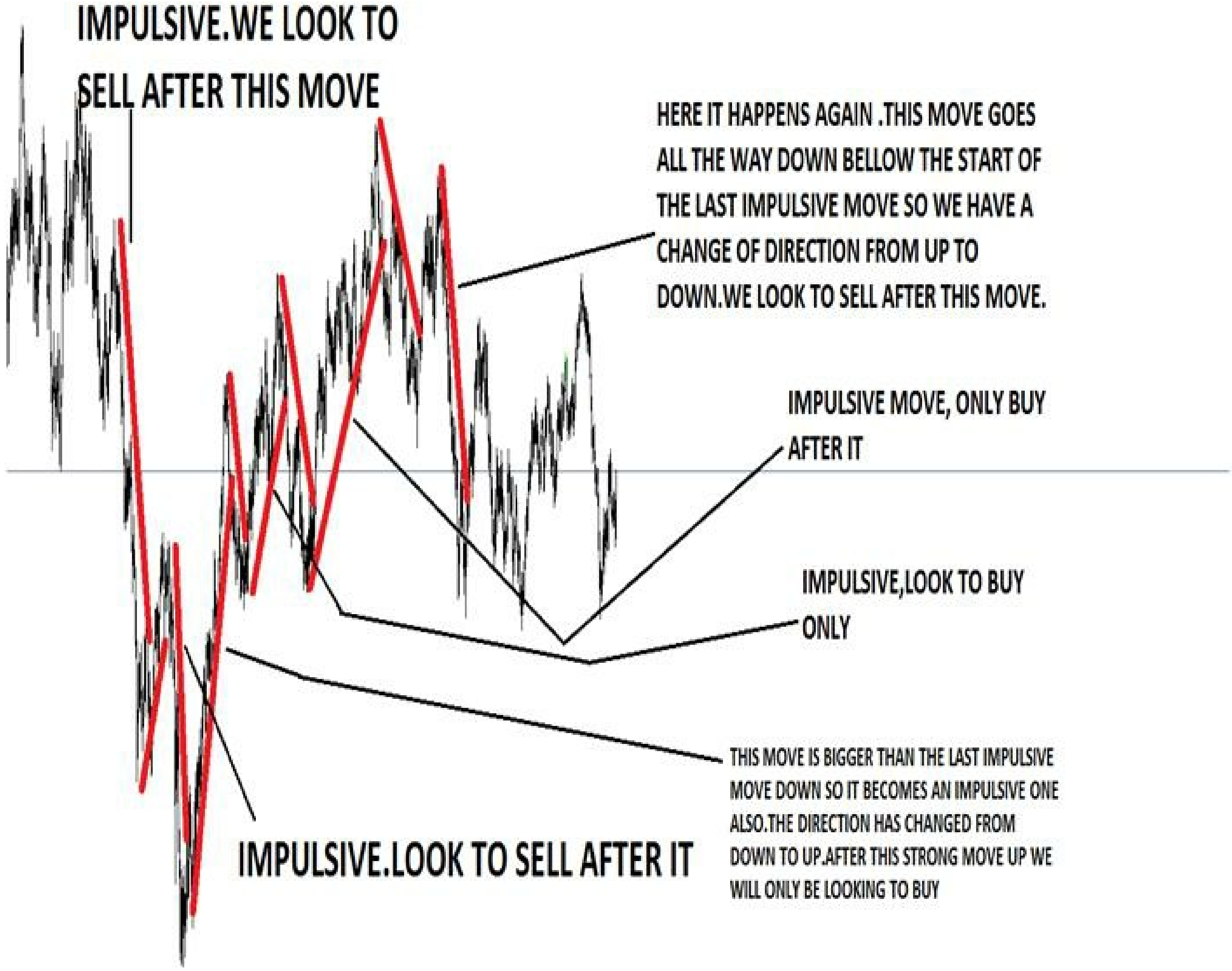
[Buy or Sell ?]
Before we start looking for price patterns and learn how to best trade them, we need first to look at the bigger picture and establish the direction of out potential trades. We do not just trade in any direction as soon as a pattern emerges on a small time frame, we go first to a higher timeframe to see who is in control at that time, the buyer or the seller. We do this by going to the 4 hours chart zoomed out to the maximum and finding the most recent big impulsive move. You probably already know that in the forex market or any other financial market the price of a pair or stock does not go straight-up or down. Instead, price moves in waves that consist of strong impulsive moves in one direction followed by corrective smaller moves in the opposite direction. These waves put together form a trend. Let us see an example of impulsive and corrective moves:

In the above example starting from left to right, we have first an uptrend. Price makes a strong impulsive move followed by a small correction move then again a strong impulsive move upwards and again a corrective small move. This repeats four times. If we have strong impulsive moves upwards it means that the direction we are looking for is clearly up as the trend is obviously up. Every time we look at the 4 hours chart and we see that the most recent impulsive move is up like in the chart above, we know that our potential trades will only be in the direction of that impulsive move, meaning we will only look to buy. The logic behind this is very simple. If the most recent big move is up, that means buyers are stronger than the sellers at this moment, so it is very likely that after a small correction move where they take some profits out of the market, the buyers will start to pick up the pace again and drive the price further up with another big move. That is indeed what happened in the chart above and it happened 4 times in a row. After this, at the very top you can see that instead of a correction small move price made a huge move down surpassing the start of the last impulsive move up. This makes this move down an impulsive move as well, it is now the most recent big move; it has gone below the start of the last move up. This means the direction of price has changed, we will at this point only look to sell if a price pattern occurs on smaller timeframe. We then have a very wide correction move where price just moves in a range, but as long as it does not go up over the start of that impulsive move down it is a correction move and the direction is still down. After the correction finally completes, we have another three impulsive moves down with the first two of them followed by small corrections. This clearly tells us that direction/trend is down and we will only be looking to sell. With this direction in mind we then go to the smaller timeframe chart and wait for a pattern to form. If the pattern is broken on the upside, we do not trade it as our direction is down and we only look to sell at this moment. As I said before, the direction or trend on the bigger timeframe shows us who is in control, which of the buyers and sellers have more power and conviction to drive the price to new levels. If the direction is up, that means that the buyers are in control, they have won the war with the sellers, they are the majority and they will drive the price up. We go with them, with the majority because it is much easier to trade profitable this way. Remember what I said in the beginning, the more people that do the same thing you do, the more chances of success. We do not trade against the majority. The same thing applies to the sellers as well. Let us see another example of how to spot the last impulsive move:

Things are clear, we have a big move down, this is the most recent big move, and the sellers are in control so we will only be looking to sell. Another example:



This is very clear as well. We only look to sell.



Here we have first two impulsive moves down after which we only look to sell, the third big move goes all the way up above the start of the previous move so it is not a correction, it becomes an impulsive move as well. We look to buy as the direction has changed. After this, we have another two impulsive moves up followed by another change in direction from up to down when that last impulsive move down goes bellow the start point of the previous. This is simple to do, just go to any chart and you will see that you can easily identify the last big move. Okay, now that we know how to identify the direction of our future potential trades let us turn our attention to the price patterns.

Price Patterns

They are formations that happen all the time in your charts and they give us very important clues about what is going on between the buyers and the sellers. There are two major categories of patterns: continuation and reversal patterns. The reversal patterns signal that a trend change is about to happen while the continuation patterns suggest that the market is only pausing for a little while before the current trend resumes. As this is a trend following day trading system, we will only use the continuation price patterns. The most popular and reliable continuation patterns are the following: flag pattern, pennant pattern, rectangle pattern, symmetrical triangle, ascending triangle, descending triangle patterns, cup with handle pattern, the price channel pattern and the wedge pattern.

Next, we will discuss in detail each and every one of them so you will have a clear understanding of how to manage these patterns.

Flag and Pennant

These two short-term continuation patterns are very frequent in the forex market. They mark a small consolidation period before the previous move resumes. In order for these patterns to be valid there has to be a sharp advance or decline preceding them. Let us see an example of a flag:

As you can see in the picture above, the flag is a rectangle pattern that slopes against the previous move. The flag in the chart above is actually not a typical one because it develops small highs and lows that you can connect with the two parallel lines. Usually flags last for a small period of time so they don’t have their own highs and lows like the one above. When this is the case, and you do not have any small highs and lows, you just need to see if you can contain the price within two parallel trend lines. Let us see another example:

You can see in the example above that if you can contain the price within those two parallel trend lines with a slope against the previous sharp move, you have a pattern. You can see that price spiked down a little bit out of the pattern but it quickly rose back up again honoring the pattern. This is just a very short spike down; if price comes back quickly inside the pattern, you can disregard it easily. Now let us find out what is happening from the buyers and seller point of view when this pattern occurs.

Well, as discussed before, this flag pattern does not work unless it is preceded by a sharp move. In the example above the sharp move up clearly shows us that the buyers have taken control of this pair because they make a strong impulsive move up. The actual flag itself means that the same buyers that drove the price sharply up are starting to take profits with their buy orders, they are closing part of their buy order. This is just human nature, people want to take profits from time to time they don’t feel comfortable holding to their order the hole day without making sure that they will make some profit.

The sellers on the other hand, when the flag pattern occurs, are not inclined to sell at that level. They can see that the buyers have won the short-term war; they know that buyers are very strong and will outnumber them at this level so they are not convinced at all to sell here. They prefer to wait for a better level, a higher level for them to sell, a higher level where the buyers will not be interested to buy anymore. As you can see, after the flag the buyers drove the price sharply up again. Ok, let us move on to the pennant pattern. The pennant shares the same characteristics with the flag pattern except for the shape. It is a small symmetrical triangle that begins wide and converges as the pattern matures. The slope of the patterns should be neutral. Let us see an example:

We have a sharp decline followed by a pennant pattern after which the sellers push the price further down. Like with the flag, the pennant is short in duration so it usually does not form its own highs and lows, in this case you just have to contain the price within two converging trend lines with a neutral slope. The logic behind the pattern is the same as with the flag. The sellers start to take profits after that sharp decline, the buyers know that the sellers are strong and will push the price down so they stay out at that level. The difference in shape is given by the dynamics of the profit taking by the sellers. If with the flag pattern, the price goes smooth and slowly against the previous move, suggesting traders are only taking small profits, in the case of the pennant, we have a more aggressive profit taking hence the shape of the pattern.

Rectangle

The rectangle is a common continuation pattern that signifies price is consolidating before resuming the trend. Price goes up and down in a tight range forming highs and lows. The highs can be connected with a horizontal line; the lows can be connected with a horizontal line. Let us see an example:

You can see that after a sharp move up price started to consolidate before resuming the previous move. It trades in a range, makes short up and down moves creating highs and lows that you can connect with horizontal lines. For a rectangle pattern to be valid, it has to have at least two highs and at least two lows. The rectangle in the above chart has two lows and three highs. It is a rectangle indeed. As this is a continuation pattern and we only trade with patterns like this that signal that the trend is about to resume we only expect for a break of the pattern in the direction of the last impulsive move on the 4h chart. If in this case, the last impulsive move had been down, we would have had to disregard this pattern because it breaks on the upside; it is not in line with the 4h chart.

Let us see another example:

Here we have two highs and three lows, and we have also a little spike to the upside. As I said before, this is not something you can worry about, forex is not exact science, and the patterns rarely do look like in textbooks. As long as the price quickly retraces back inside the pattern and the respects again the first high creating a horizontal resistance line as it did in this chart, things are more than okay. The logic behind this pattern is the following. Buyers and sellers start to play some ping-pong with the price. They have equal forces; there is great equilibrium between them. In this example buyers make a strong move up after which they start to take some profits. At this time sellers are beginning to show interest so the sell making the first high of the pattern, when price gets lower buyers think it’s time to resume the previous move so the push the price up, but they don’t have enough force to push it above the level where the seller have shown interest last time. At that level the seller come in again and push the price back down creating the second high of the pattern.

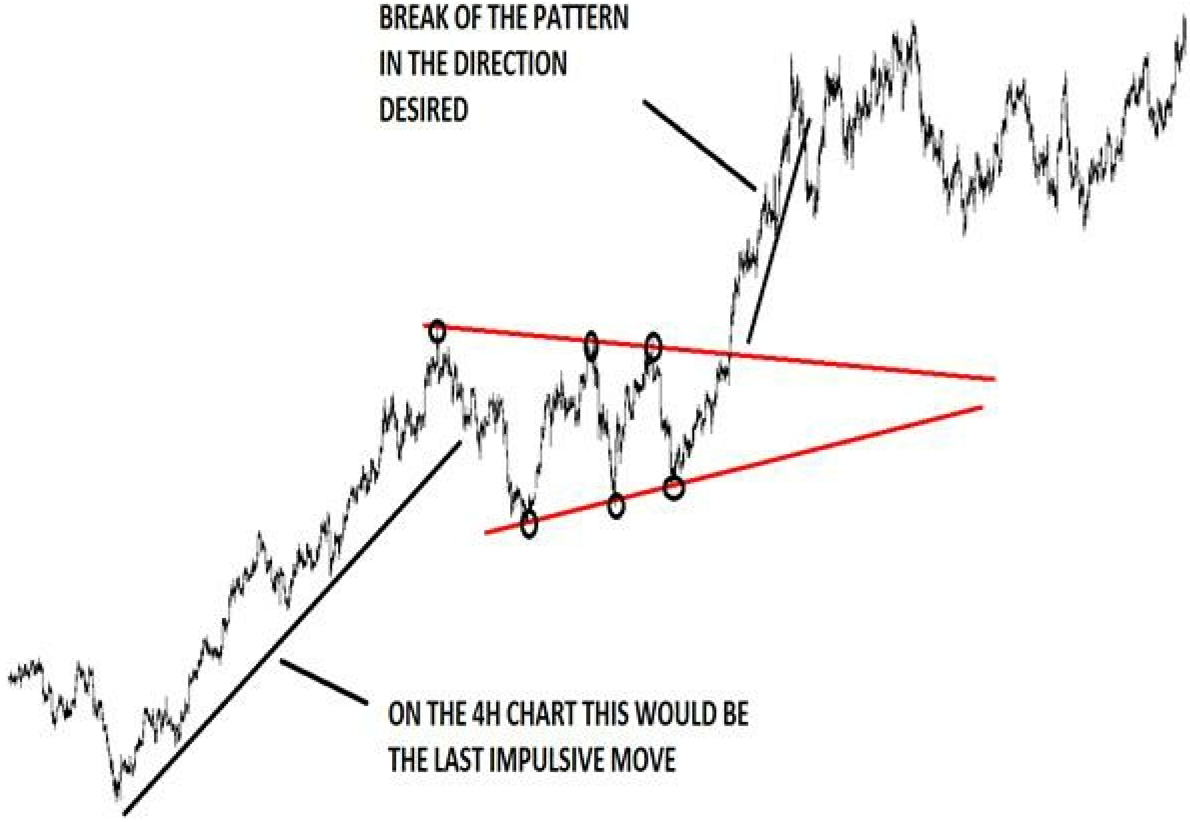
This goes on until one side gives in and that is when the price pattern breaks in one direction or the other. It is a simple pattern, buyers and sellers are at war, and nobody is winning. We just sit tight and hope that the pattern brakes in our predetermined direction of potential trades.

[Triangles]()

There are three types of triangle patterns, symmetrical, ascending, and descending.

Symmetrical triangle: this is a continuation pattern that contains at least two higher lows and two lower highs. When you connect the higher lows and the lower highs, you obtain two trend lines that converge. Let us see an example:

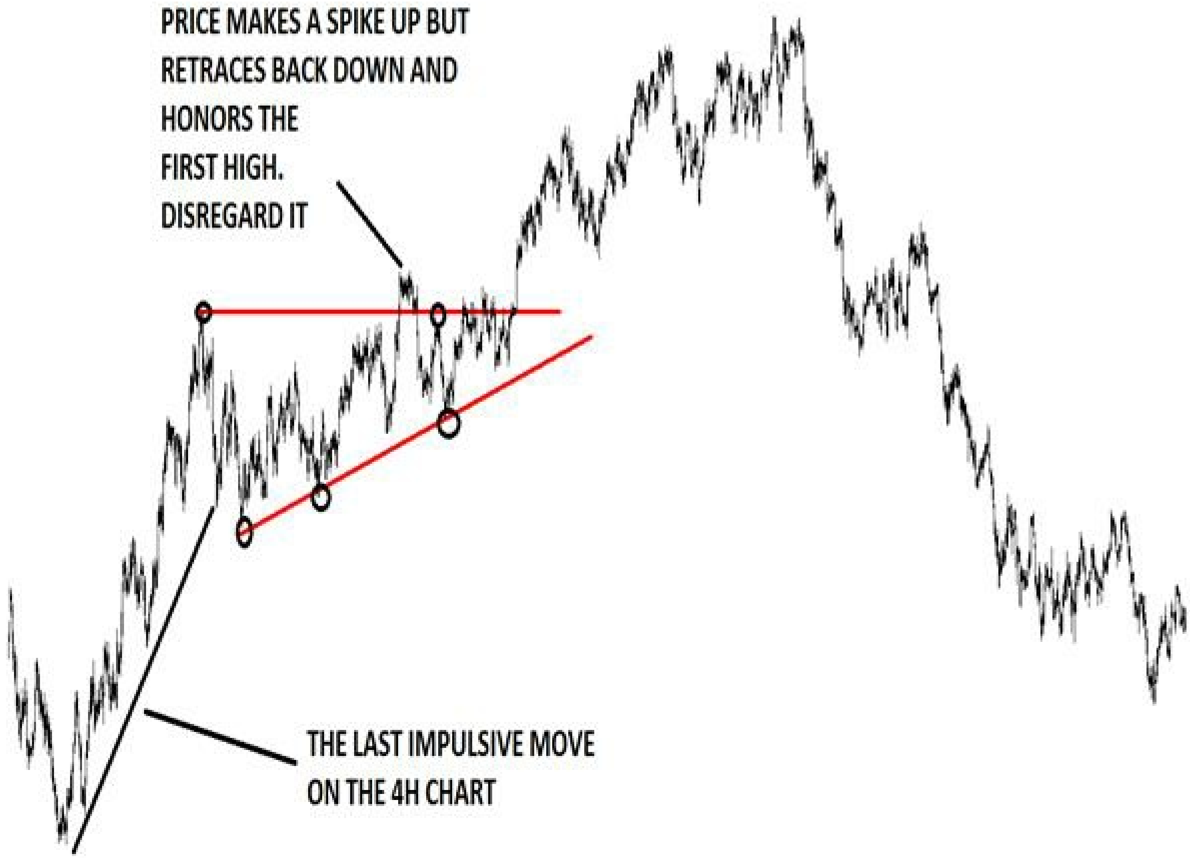
In this symmetrical triangle, we have two lower highs and three higher lows. The impulsive move on the 4h chart was pointing up; price makes a continuation pattern on the smaller timeframe and then resumes the prior move. As you can see, it is quite similar in shape with the pennant pattern discussed earlier but this symmetrical triangle takes more time to form, has to have lower highs and higher lows, and does not have to be preceded by a sharp move like the pennant pattern. Another example:



In this example, we have three higher lows and three lower highs. Price makes an impulsive move up on the 4h chart, then a symmetrical triangle occurs on the smaller time frame (the time frame in the above chart), pattern breaks and continues the trend up. The logic behind this pattern is this: the buyers push the price up making higher lows but at the same time, the sellers push the price down making lower highs. This narrowing trading range can only mean that the buyers and the sellers are losing interest in that price level. As you can see, the pattern starts wide and it begins to narrow when approaching its end. When the trading range where the battle of buyers and sellers takes place begins to narrow this always means that a big sharp move in either direction is about to emerge after the break of the pattern. This narrowing means low volume of orders in the market at that level; the buyer considers that the price level is unattractive for him to buy. The seller thinks that the level is unattractive for him to sell. However, when price breaks out of that small range, the price starts to move fast in one direction or another.

Ascending triangle: this is a bullish continuation pattern. It must have at least two highs and two lows that you can connect with trend lines. The upper trend line must be horizontal; the lower trend line must be a diagonal one like in the chart below:

This being a bullish pattern we must make sure first that the most recent impulsive move on the 4h chart is also a bullish one. You can see we have two highs and three lows here, pattern breaks on the upside as expected. Here is another ascending triangle:



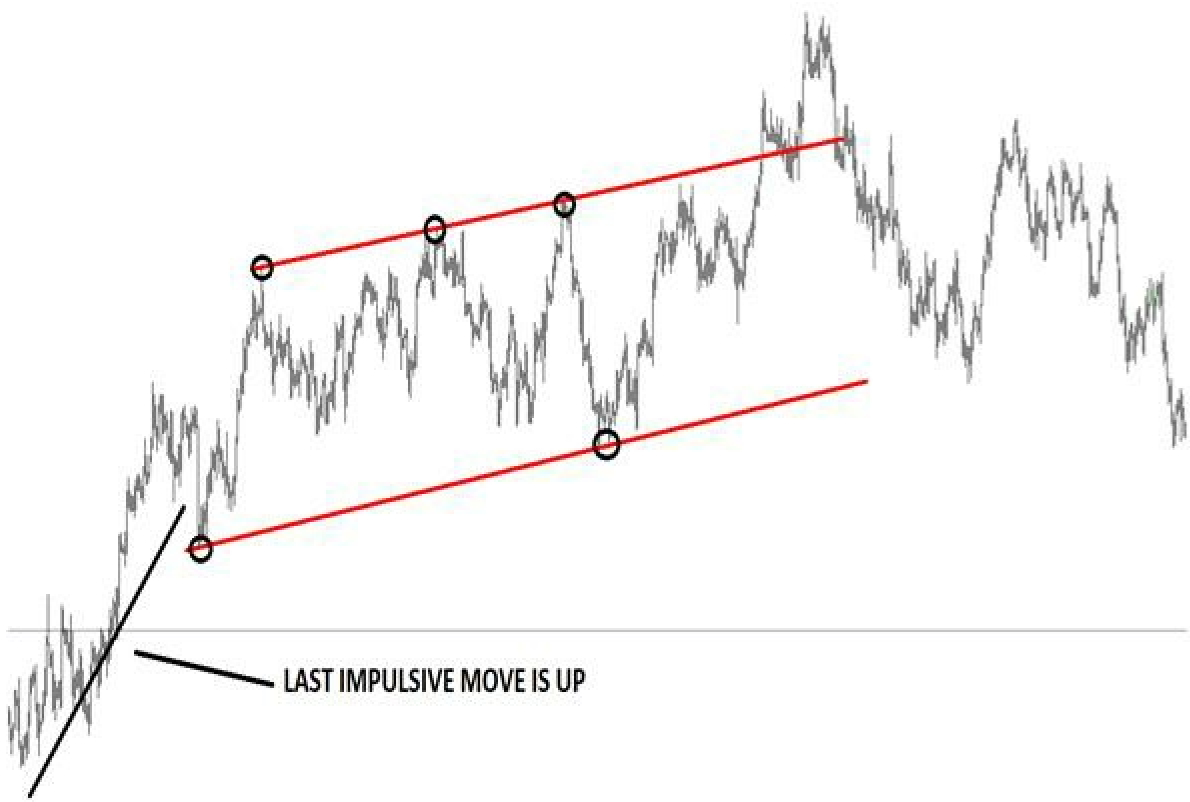
Here we have another example of how well this pattern performs. The logic behind this pattern is obvious and you have probably figured it out. The sellers are not letting go easily of that level where the horizontal trend line is, but the buyers are very persistent and they start to push the price higher and higher making higher lows. Eventually, the sellers will admit defeat and stop entering sell orders at that horizontal line. They will have no choice because every time they sell the buyers push the price back up to where they sold and trigger their stop losses. The sellers are outnumbered; the buyers have clear control. After that, the pattern breaks and the buyers resume the trend established by that previous impulsive move up.

Descending triangle: this pattern is pretty much the opposite of the ascending triangle. It is a bearish continuation pattern meaning the trend is down, price stops for a while to consolidate forming a descending triangle pattern and then it goes further down resuming the trend. Here is an example:

There is a minimum requirement of two highs and two lows with this pattern as well. The logic behind it mirrors the one from the ascending triangle. The sellers are the majority, the trend is down, the buyers hold their ground at the horizontal trend line but only for a short period of time. The sellers win and they break the pattern to continue the trend downwards.

Price channel

The price channel is also a continuation pattern that consists of two parallel trend lines, one above and one below the price that take the shape of a channel. If the channel is sloping upwards then it is a bullish pattern, if the channel is sloping downwards then it is a bearish continuation pattern. Like all the other patterns, each trend line must be drawn connecting at least two high and two lows. Let us see an example of this pattern:



This price channel is sloping upwards so it is a bullish continuation pattern. The last impulsive move on the 4h chart should be up for you to consider trading this pattern when it breaks to the upside resuming the trend.

In this example, we have a bearish price channel pattern because its slope points downwards. We also have a downtrend in place because we found on the 4h chart that recent impulsive move down.

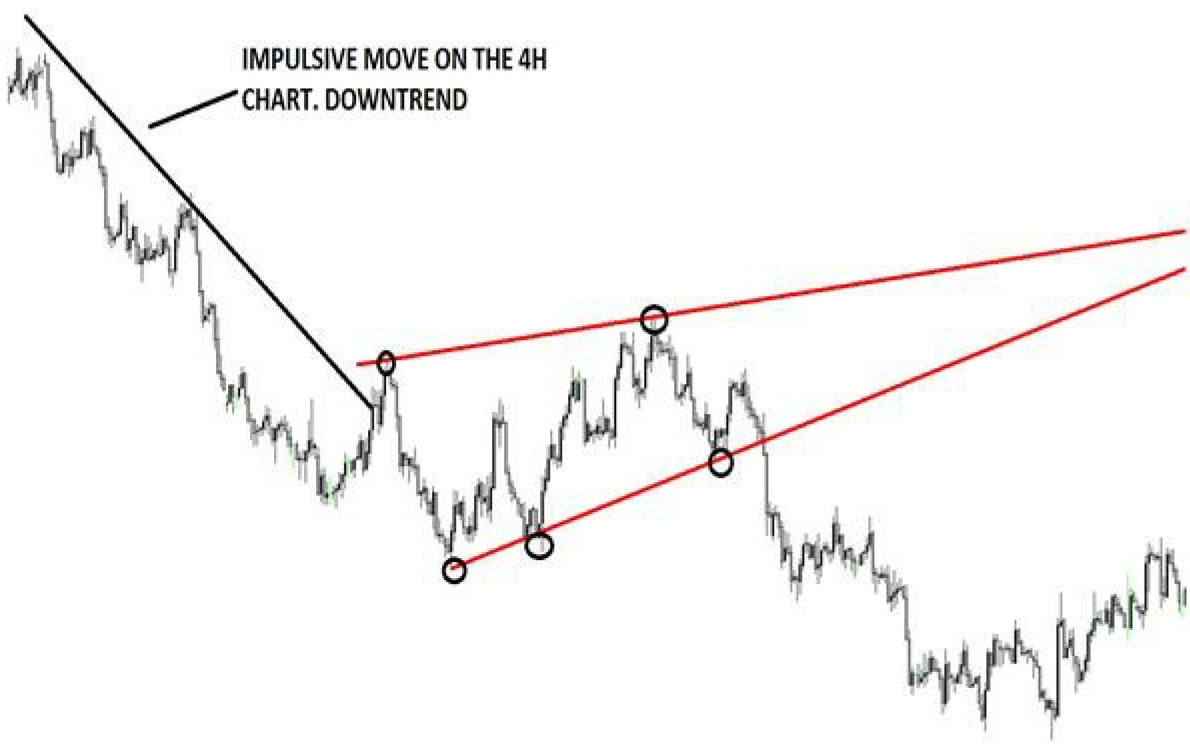
The logic behind the price channel pattern is the following: when the trend in up, the buyers are in control, price stops to consolidate when they decide to take some profits out of the market but the sellers are nowhere to be found. They don’t even have the strength to correct the trend, to make a small correction move against the trend direction so price just trickles upwards slowly forming a channel before the buyers start to resume the strong trend by breaking this slow moving pattern and continuing the move up. The same thing applies for the bearish price channel but the roles are changed between the buyers and the sellers.

Cup with handle
This is a continuation pattern as well and as the name says, it takes the form of a cup with a small handle. Let us see what I am talking about:

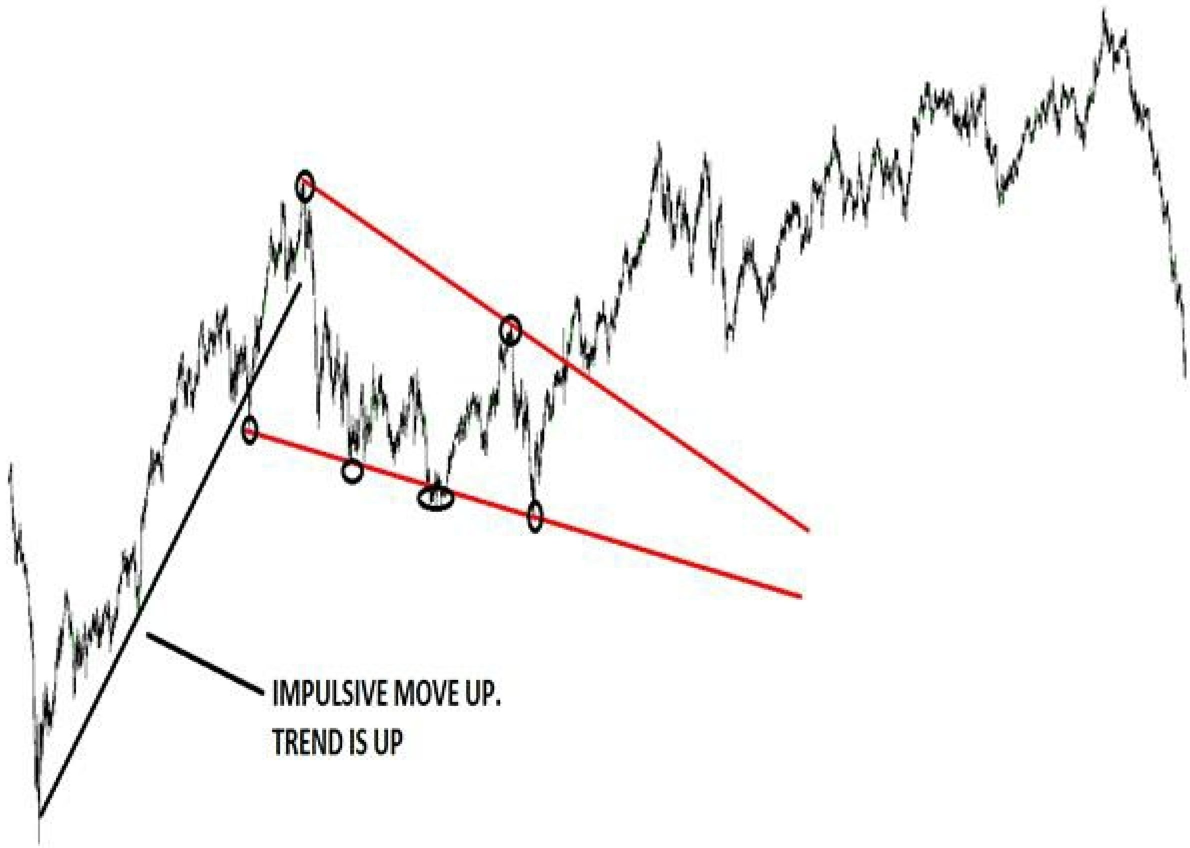
This pattern also has to have at least two highs or lows that you can connect with a horizontal line like in the chart above. You can see that the trend is up, this pattern forms in a correction of the trend but it is no ordinary looking correction. It is in the form of a cup; price goes slowly down and then reverses just as slowly forming a cup shape. When it gets back up to where the correction started price makes another formation against the trend that resembles a handle. It usually looks like a flag pattern on its own but when put together with the cup it forms the cup with handle continuation pattern. The logic behind it is that the buyers, in this case, have driven the price up for a long period of time making a big uptrend and now, at the level where the pattern formed, they decide it’s time to scale down a big part of their orders and take some well-deserved profits. But because the uptrend was so big that means that there were much more buyers than usual to push the price up for that long period of time so now there are also much more buyers that have to take profits so the correction move is also long in duration. Because it is long in duration, the sellers have time to gather their forces. The first part of the cup is a classic correction that looks almost like a flag pattern. After that, when the buyers decide that it is time to push the price back up to resume the trend, they face quite a strong resistance from the more and more sellers and they can only push the price up slowly forming the cup. After the price comes back up to where the correction started at that red line, the seller know that this level is their territory as the sold there before so they join forces and sell there again. The move down does not last long and the sellers have to admit defeat as the buyers awake with conviction to continue the trend.

Wedge

The wedge can be a continuation pattern and a reversal pattern but we will focus only on the wedge as a continuation pattern as we seek to trade only with the main trend. A continuation wedge pattern is always situated in the correction move against the trend or last impulsive move. Like all other patterns is has to have at least two highs and two lows. A continuation wedge pattern that forms in an uptrend is called a falling wedge; a continuation wedge pattern that forms in a downtrend is called a rising wedge. The slope of the wedge pattern always has to be against the main trend or against the direction that we look to trade in. In addition, the two trend lines have to converge. Let us see a chart with such a pattern:



We have a clear downtrend established by that 4h chart last impulsive move. The trend enters a correction faze and a rising wedge is formed. Yes, I know, it looks like a symmetrical triangle but it is not. The symmetrical triangle has a neutral bias, this rising wedge always has an upwards slope and is valid only in downtrends. Let us see a falling wedge as well:

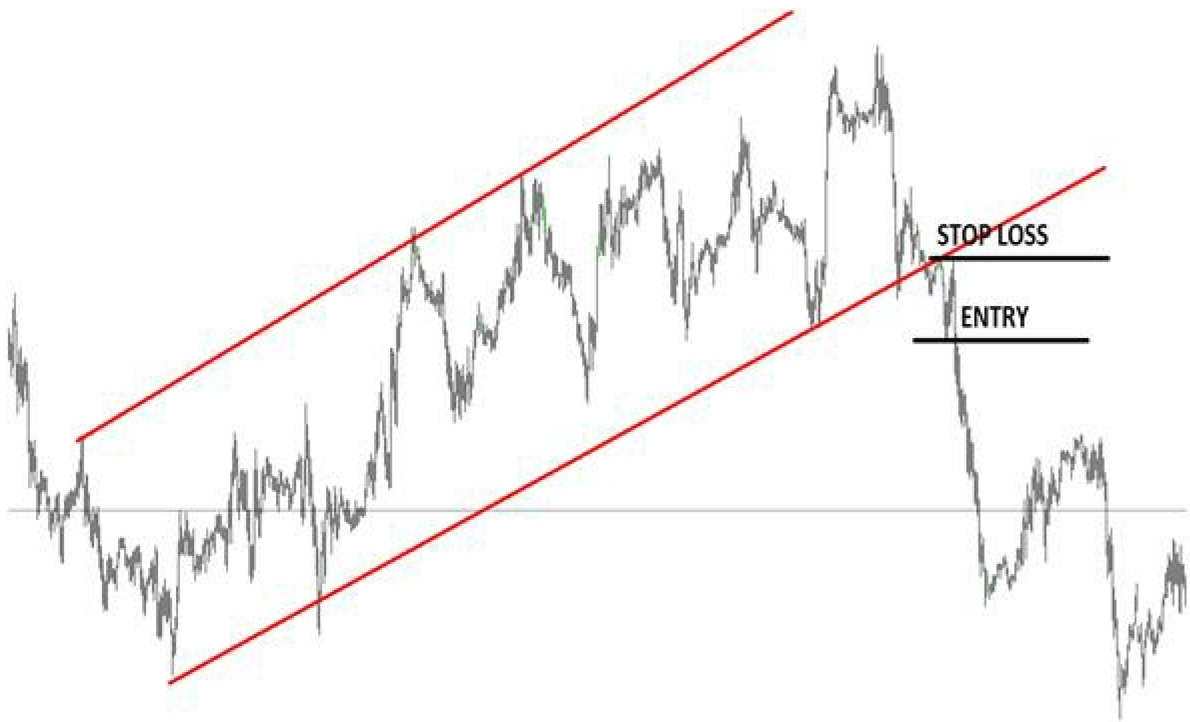


We have an uptrend, price enters correction faze, a falling wedge takes shape. The logic behind these wedge patterns is pretty much that of the symmetrical triangle except that here we have a bias. In the example above, the buyers start to take profits and a correction move against the trend develops. The trading range starts to narrow which signals that the buyers will soon break the pattern to the upside and resume the trend. Like with the symmetrical triangle, this pattern usually results is some pretty strong moves but there is a difference which makes this pattern even stronger. The symmetrical triangle has no slope, no bias, but in a correction move against the trend, the short-term bias against the trend is a good thing for the health of the trend, it means that the people who drove the price up or down are taking profits and they will continue the trend further. No bias against the trend or neutral bias means that the same people did not take enough profits at that level and they might start to take them later, which implies that the trend will not continue very strongly, or sharply. Here is something important for you to consider when trading patterns. They develop in the correction phase of a trend and these correction moves usually respect the Fibonacci retracement levels. Not always, but very often they do. It is wise that before considering trading a pattern, to make sure that the correctional move that is in fact the pattern itself has retraced at least to the 38.2% Fibonacci retracement level of the impulsive move. Here is what I mean:

Here we have a big impulsive move up after which the correction retraces exactly to the 38.2% level. This is a good correction and if there had been a pattern there, this would have been a good trade. The idea behind this is to give you a guideline when trading the break of a pattern. If a pattern forms early in the correction move it could not be a good pattern because the correction is not complete and the price can very well break the pattern in your desired direction only to reverse, hit your stop loss and continue the correction move at least to the 38.2% Fibonacci retracement level. This is why I recommend to you that if you see a pattern that you think is going to break in the direction you are expecting, first draw the Fibonacci retracements tool on the impulsive move to see if the correction is big enough.

Entry and Exit

Now that we have learned about impulsive moves and about all the price patterns it is time to learn about how we can trade these patterns when they occur, how to enter in a trade and how to manage the trade so that we can obtain a maximum profit. Let us see some trade examples:



Here we have a flag pattern. The last impulsive move on the 4h chart was down so we go to the 30 minutes chart (this chart above) and wait for a continuation pattern to form. After it forms, we wait for it to break in the direction of our impulsive move. In this case, we seek to sell so we want the flag to break on the downside. When I say break I mean for you to zoom out the 30 minutes chart and wait for a 30 minutes candle to close outside, below the flag pattern. After this happens, you zoom out the 30 minutes chart and wait for the price to go back up to the red lower trend line and retest it or get close to it. This line is now a resistance line and often after a pattern brakes, price comes back shortly to retest it like in the chart above. We had a break of the flag to the downside; price rose back up to retest the lower trend line and then continued its way down resuming the trend. We enter the sell stop order at the level where the price started to rise back up and retest the lower trend line of the flag. The stop loss is placed at the level where the retest of the trend line took place as shown in the above chart example. Now let us see how we manage the stop loss level:

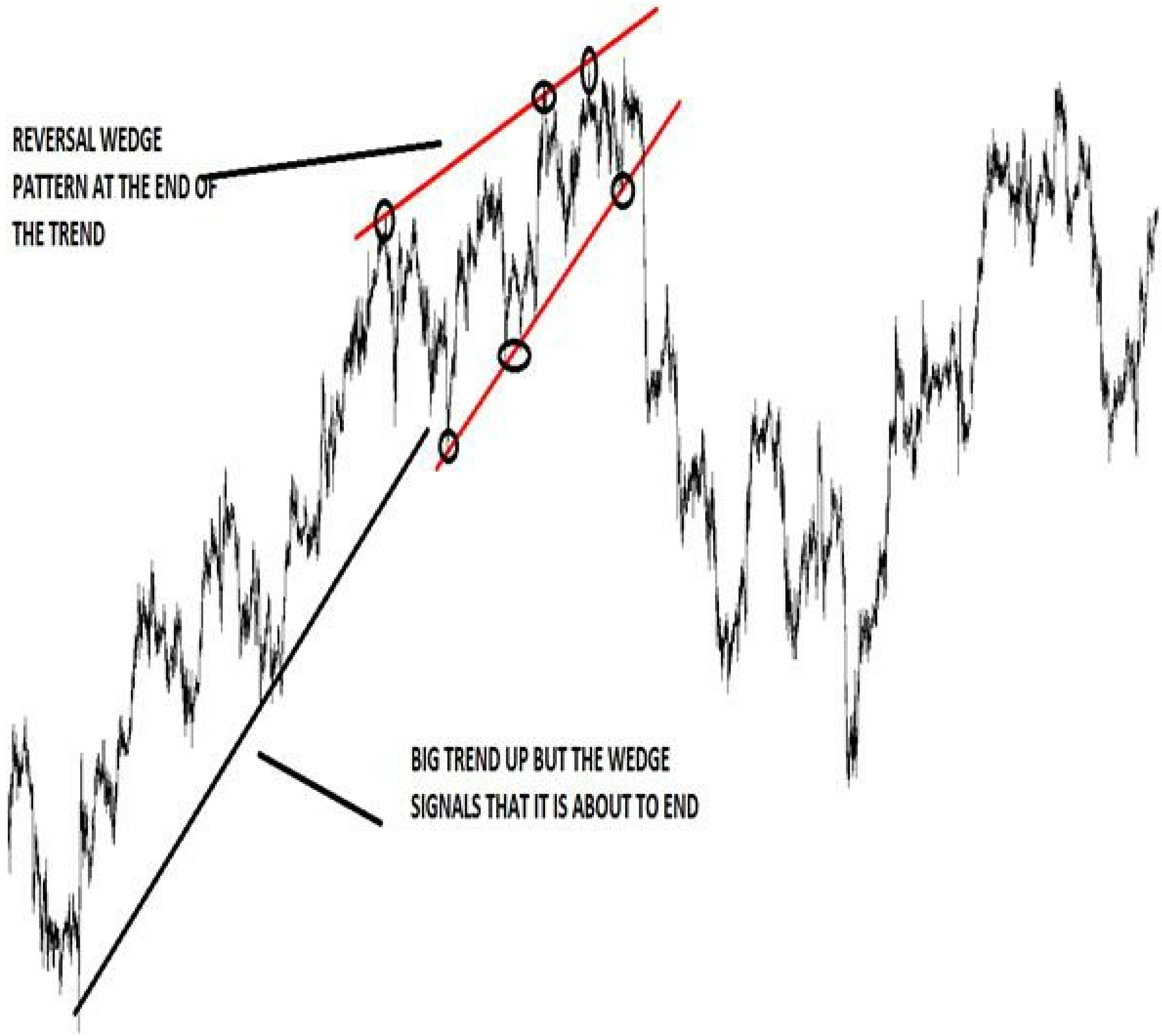
This is the same 30 minutes chart and the same trade. As price begins to move away from the flag pattern it starts to make small lower highs. We trail manually our stop loss level just above those lower highs.

Let me tell you some things about the trade entry level. We have two ways to enter the trade. The first is to wait for the retest of the pattern like in the example above; the second is to enter when a 30 minutes candle's body is completely outside the pattern if the retest did not happen right after the first candle than closed outside it. This is because there will be times when the trend is to strong and the retest never happens. Let us see a chart:

Here we have a descending triangle in a clear downtrend with the recent impulsive move on the 4h chart down. The pattern brakes to the downside, as we want it to break but after the first 30 minutes candle that closes outside the pattern there is no retest of the lower trend line. If there is no retest after the first candle that breaks the pattern, we enter at the close of the second candle that is completely outside the pattern. You should not wait for the retest, if it did not happen after the first candle there is a good chance that it will not happen at all. We place the stop loss above the last minor lower high inside the pattern. Then we trail the stop loss manually exactly the same way as in the first example where we entered the order after the retest of the pattern.

Here we have the same situation. We have an ascending triangle, most recent impulsive move on the 4h chart is pointing up, but after the first candle that closes above the pattern there is no retest, so we enter the trade at the close of the second candle, which is completely outside the pattern. We do not want to miss a good opportunity to make some pips by waiting for a retest that will never come.

Here we have a rectangle pattern. After the break candle that closes outside the pattern, the retest begins. We enter when price comes back down at the close of the breakout candle, and we set out stop loss where the retest finished and price started to go down away from the pattern. Now, about exits, I have already told you that you have to trail manually the stop loss just above the lower highs on the 30 minutes chart when you are selling or just below the higher lows if you are buying. These are logical turning points in the market, they are the least probable levels for the price to touch when there is a strong direction therefore they are a very good place to hang your stop loss. However, there is another way to exit a trade earlier than this and you should use it if the market offers the opportunity. When I discussed about the wedge pattern, I told you that this pattern can be a continuation pattern but it also can be a reversal pattern. It very much depends of its location. If it forms in the correction phase of the big trend on the 4h chart and it is sloping against this trend then it is a continuation pattern and we use it as described above to enter trades. This pattern can also emerge in the impulsive moves of the trend signaling that the trend is about to end. The slope should be in line with the trend. Let us see a chart:



Here is an uptrend that finishes with a reversal wedge pattern. If you are in a trade and you see this pattern emerging you keep an eye on it to see if it breaks counter the trend to confirm that the trend is at its end. Of course, the main approach for trade exits remains the manual trailing below or above logical points. Nevertheless, if you see a wedge that breaks to the downside if in an uptrend or to the upside if in a downtrend, then you should exit when this pattern breaks, when a 30 minutes candle closes outside of it to confirm that the trend is ending. This gives you a better exit level as you do not have to wait until price goes back to the last high or low to hit your stop level and eat away a small part of your profit.

Step by Step

Here is the system from a chronological point of view.

-Go to the 4hours chart zoomed out to the maximum and find the most recent impulsive move

-Go to the 30 minutes chart and look for patterns like those explained earlier in this book. If a pattern emerges, you wait for a breakout in the same direction as the impulsive move on the 4h chart. If the breakout of the pattern is not in the same direction as that of the impulsive move, do not trade it. Go to the next chart or pair and do the same.

-If the breakout direction of the pattern is in line with that of the impulsive move, enter the trade like shown in the entry and exit section. Trail manually your stop loss under or above every minor higher low or lower high, that price makes on the 30 minutes chart.

This is about it.

In the end I would like to apologize if I sound a little to rigid in my explanations and if there are any misspellings. English is not my first language. I am doing the best I can.

If you find that this adds value to your trading please consider writing a review of the book on Amazon. It does not have to be long, just a few words to state your opinion about the trading system presented in order to help other people make more informed decisions.
Please email me afterwards at damirlaurentiu@yahoo.com and you will receive the PDF version of this e-book so that you can read it more easily and print the contents on paper if you want.

Day Trading Forex with Price Patterns

Thank you very much.

In addition, if you want to combine this trading system with other powerful forex price action methods for better results and much more pips you can check out these books:

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Link: Follow Price Action Trends
Link: Day Trading Forex with S&R Zones
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Link: 50 Pips a Day Forex Strategy