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Advanced Forex Trading Ideas



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Advanced Forex Trading Ideas

These ideas presented in this eBook are intended for the intermediate forex traders who want to extend themselves and want to progress to the next level. This book is also for the advanced traders as either a review, or a refresher course or simply to pick up a new trading idea or two. Other forex eBooks available on TradingProfits.org.

We will be going some advanced concepts. We will assume you have some knowledge of the forex markets.

Pivot Points – A Technical Analysis Technique in Forex Trading

The great element of learning technical analysis is that the skill is transferable across the variety of tradeable market types and financial instruments. This is because, the underlying definition of technical analysis is that it is the study of mass market psychology, studying patterns to unearth some pattern to reveal future price movements. It is important to note that the technical indicators you choose is a choice which depends upon your trading style. For example, a long term trader would rely on lagging indicators such as moving averages and a short term trader would seek a predictive indicator, such as the pivot point.

Pivot point analysis is a predictive indicator. The analysis itself attempts to find support and resistance: and by the very nature of the indicator, these indicated levels are short term in nature and must be calculated frequently (depending on the length of time you are looking at).

These pivot points are derived by a calculation of the numerical average of the currency price's high, low and closing prices. You may use short term time periods such as intra-day, daily and weekly. Forex traders use these pivot point support and resistance levels as a guide as to the probable turning points for the trading in that time period. If the market opens between

“...intended for the intermediate forex traders who want to extend themselves”

these levels (in forex "opens" either refers to the start of the week, or simply the time frame you are looking at – ensure that your time frame also includes and significant price levels) than it is probable that the price may bounce off the support and come back towards resistance (i.e. a trading range pattern). Or a break of either support or resistance may signal a far greater move which either continues or reverses the trend.

It may be wise to implement Pivot Point analysis in your forex trading. It is possible to run this analysis at the start of your trading day to find any potential turning points.

Interest Rate Trends and Currency Correlations

My friend was telling me that a few currency pairs are strongly correlated. Which currency pairs should I be looking at to find these correlations and can I use these to trade?

There are correlations between currency and interest rates but since there are many variables in the economy, this relationship is dynamic and the magnitude or whether they correlate changes with time. Sometimes the currency acts in a very correlative manner with respect to interest rate movements, sometimes it doesn't – it isn't a perfect relationship, and as such your trading plan must work around this fact.

“Sometimes the currency acts in a very correlative manner with respect to interest rate movements, sometimes it doesn't”

The most noticeable correlation over recent times (mid 2007) was the flow of cash into high yielding currencies: AUD/JPY and NZD/JPY. The Australians and the New Zealanders have high interest rates and the Japanese have cheap cash to invest. This is often called the carry trade. Many professional institutional traders use this tactic and as they look for return, currency volatility remains low. However, changing economic circumstances may end the carry trade or change its profile.

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There is also a strong relationship bond between currency and commodities. (Yep, even without that pesky gold standard from the past) A strong gold or oil price usually (not all the time) has a positive correlation to commodity countries like Australia, Canada, South Africa and Norway. If gold is strong I would be looking closely at AUD and ZAR (South African Rand). If Oil was moving and volatile, I would be having a look at Canadian CAD or Norwegian NOK. So if oil price was strong, a country like Japan which imports nearly all oil would be hurt from the higher cost.

The complexity to currency correlations is that all currencies in the world are inter-related with one another in a very complex web of cross rates. Not only currencies are listed against the USD but they are also listed against other nation's currency. For example, AUD/USD, EUR/USD, USD/JPY and their cross rates: AUD/JPY, EUR/JPY, EUR/AUD.

This complexity means that a movement of one currency price has an affect on cross rates with other currency prices. There are also other economic data to assess, such as GDP, employment, non-farm pay rolls, etc... Other factors to watch out for are governmental interventions on the market in terms of laws or changes to their economic dynamics such as instant interest rate changes or the volume of money in circulation.

Correlations do exist but the correlations between the currencies and the interest rates vary depending upon the present economic circumstances.

AUD/USD Fundamental Economics

Key factors that influence the Australian economy are at present (2007-2008): commodity prices, global growth, developing countries, interest rates and consumer debt.

Commodity prices are a major influence to the Australian economy. There has been greater demand in commodity trade as a result of developing countries like India and China requiring more of the raw stuff. Price for commodities have also been high. As a result of increased demand and price, there has been strong employment growth and consumer demand in Australia, especially the mining regions. Another set of major influences to the Australian economy are the interest rates and consumer debt. Increasing levels of consumer debt have the Reserve Bank of Australia (RBA) concerned and have been

tightening monetary policy by increasing interest rates.

Risk Management: Managing Volatility in Forex

I find that the forex markets are more volatile than stocks. Should I be increasing my stop, although it increases my risk – it gives my trade room to move? I don't like getting stopped out of trades too often.

Volatility is great – the more volatility, the better for a trader since it presents more opportunity for long and short trades. You are on the right track. You have a plan and you consider the amount of risk you are undertaking before putting on a trade. It is the most critical part of trading: that is, having a trading plan and for every trade to have a stop loss and a known amount of risk. These two pieces of information can tell you how much your position size should be when you initiate the trade.

For position sizing: Risking 2% of total portfolio example:

Stock XYZ is trading at \$60 per share

Portfolio size of \$100,000

The stop loss is 5%

Risk will be \$2,000 = ($\$100,000 \times 2\%$)

Amount to Trade at 5% stop: $\$40,000 = (\$2,000 / 5\%)$

Shares to be bought: 667 = Your Position Size

Where you place your stop can be dictated by the above equation and how you want things to turn out. But it should not be the case. You must consider the charts before putting any trade on the table and setting any stops. Your stops must be in reference to chart patterns (that is, if you are basing your trading on technical analysis). Take note of the support and resistance levels. Place your stops slightly below (if long) or slightly above (if short) technical support levels.

As for forex, widening your stops and increasing your risk. I disagree. You have the power of controlling your own risk. As much as controlling your own destiny. You can control the amount of risk you have exposed to the forex market by reducing your position size, all the while leaving your stop loss level at the price it should be. If you cannot afford to have a stop loss at the position your plan tells you to have it: then either cut your position or don't even think about initiating the trade. Remember, to survive in trading you must have discipline to follow the plan.



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