

ANDREW ELDER

TECHNICAL ANALYSIS FOR BEGINNERS

**CANDLESTICK TRADING, CHARTING,
AND TECHNICAL ANALYSIS**

**TO MAKE MONEY WITH FINANCIAL MARKETS
ZERO TRADING EXPERIENCE REQUIRED**

Technical Analysis for Beginners

*Candlestick Trading, Charting,
and Technical Analysis to Make
Money with
Financial Markets
Zero Trading
Experience
Required*

Andrew Elder

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Introduction

Technical analysis has some similarities to fundamental analysis but is different in its approach. It is important to understand both of these aspects of analyzing a stock. Technical analysts use charts, market indicators, and other tools to predict future price movements. They study the patterns of supply and demand over time or trade volume on a particular stock or index.

In contrast, fundamental analysts focus their attention on company finances and economic data about industries for which the stocks trade (also known as industries). They are concerned with factors like corporate earnings reports, profit margins, unemployment rates, and gross domestic product (GDP) growth rates. They examine these economic factors to determine how they will affect the demand and supply of a particular stock.

Technical analysis is more concerned with the price movements of a stock or an index by examining historical records of trading activity. A technical analyst looks at past data to predict future price movements. They believe that history tends to repeat itself in the stock market and that past performance is the best indicator of what will happen in the future.

The difference between these 2 approaches really boils down to who is in control, whether it be fundamental or technical.

Technical analysis is concerned with things that a company does not directly control. For example, stock prices constantly react to whether or not people are optimistic about the future of a stock. If lots of people are buying a certain stock, it will typically go up in price. People are optimistic about that stock because they think it has potential for future growth. Unfortunately, the characteristics of fundamental analysis do not directly affect how much people are interested in buying a stock or what their expectations for its future growth might be.

In order to provide this kind of insight into its performance, fundamental analysts turn to earnings reports and other data released by companies that provide some indication of how well or poorly they are performing. The fundamental analyst looks at how the company is doing as a whole and tries to get an overall grasp of how the market reacts to these reports.

The technical analyst, on the other hand, is more concerned with the stock's past performance and charts this data in order to predict its future movement.

This analysis uses many different tools and a variety of charts such as bar charts, line charts, and candlestick charts. These charts help traders identify things such as the strength or weakness of support or resistance levels, which can be identified by drawing trend lines through significant highs or lows in price movements on a chart. Trend lines are used to identify optimal entry and exit points in the market.

The actual tools used in charting may differ from one technical analysis tool to another, but they each provide some unique insight into history. Technical analysis can be a useful way for investors to decide whether or not an investment is worth their money. It can help determine the future value of a stock by looking at its past performance.

For example, if a stock has historically closed at \$20 per share and it drops to \$15 per share, then there may be

some reason for investors to believe that the price will move back up again closer to \$20 per share as opposed to breaking through the support level.

Chapter 1. What Is Technical Analysis

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Technical analysis is turning into an inexorably famous way to deal with exchanging, thanks to some degree to the progression in charting bundles and trading platforms. In any case, for a beginner trader, understanding technical analysis—and how it can support foresee patterns on the lookout—can be overwhelming and testing.

Technical analysis analyzes price movements in a market, whereby traders utilize striking chart patterns and indicators to predict future patterns on the lookout. It is a visual representation of the execution at different times of a market. It permits the trader to utilize this data as price activity, indicators, and examples to direct and educate future patterns before entering a trade.

This guide, *Technical Analysis for Beginners*, will acquaint you with the essentials of this exchanging

approach and how it may be used to trade the monetary business sectors.

Understanding Technical Analysis

Technical analysis includes the understanding of examples from charts. Traders utilize important information considering price and volume and use this data to distinguish exchanging openings dependent on basic examples on the lookout. Various indicators are applied to charts to decide section and leave focuses for traders to boost a trades potential at great danger reward proportions.

The underneath chart is an illustration of a diagram with the utilization of the MACD and RSI indicators.



While investors of technical analysis accept that financial variables are the primary supporters of movements in the market, technical analysis traders keep up those past patterns that can support anticipating future price movements. Albeit these exchanging styles can shift, understanding the contrasts among principal and technical analysis—and how to join them—can be very helpful.

Study consolidating key and technical analysis.

How Technical Analysis Can Support Traders

Numerous traders have discovered technical analysis to be a valuable apparatus for hazard the executives, which can be a key hindrance. When a trader comprehends the ideas and standards of technical analysis, it very well may be applied to any market, making it a versatile logical device. Where key analysis hopes to recognize characteristic worth in a market, technical analysis hopes

to distinguish patterns, which helpfully can be brought about by the essentials.

Advantages of using technical analysis incorporate the accompanying:

- Can be applied to any market using any period.
- Technical analysis can be used as an independent technique.
- Allows traders to distinguish patterns on the lookout.

Using Charts in Technical Analysis

The beneath chart is an illustration of a candle chart for the EUR/USD cash pair.



Technical analysis was developed to figure future price patterns in different business sectors. It is the foundation of analysis for some traders in the present quickly evolving markets.

There are 2 analysis instruments that traders and financial backers use for anticipating future price patterns: Technical analysis and fundamental analysis. In this guide, we will examine the first of the 2. We will discuss a wide range of technical analysis metrics, which will be a somewhat expanded guide.

When all is said in done, numerous traders utilize both, technical and fundamental analysis consolidated. Be that as it may, some trust one is better than the other and works better. Whichever the case, regardless of whether you are a bad-to-the-bone fundamentalist, you can't

ignore the way that numerous traders utilize technical analysis and follow through on regard for some key price levels. Furthermore, that can move the market the other way to that proposed by basic research alone. If enough individuals accept a specific technical highlight to be pertinent, it will undoubtedly be market-moving and represent the deciding moment of a trade. For this very point, it delivers profits to know about technical analysis in the business sectors, at any rate at a fundamental level.

A Brief History of Technical Analysis

A few parts of technical analysis started to show up in Amsterdam-based trader Joseph de la Vega's records of the Dutch monetary business sectors in the seventeenth century. Nonetheless, many credit technical analyses to Munehisa Homma (1724–1803), additionally alluded to as Sokyu Homma or Sokyu Honma. He was a well-off rice vendor and trader from Sakata, Japan, who lived during the Tokugawa Shogunate. He is credited as a pioneer of technical analysis because he developed Candlestick Charting, which is a spine of technical analysis right up 'til today.

At first, in Japan, just actual rice was traded, yet starting in 1710, a fates market was set up where coupons addressing future conveyance of rice were traded. Homma was a fruitful trader in this optional market of exchanging rice coupons. Famous for his capacity in exchanging the rice market, Homma turned into a monetary guide to the public authority and was even granted the position of privileged Samurai. In 1755, he composed *The Fountain of Gold: The 3 Monkey Record of Money*, a book zeroed in on market psychology research. Hundreds of years after the fact, the Candlestick Charting method has been brought toward the Western world and is presently used by numerous traders everywhere in the world.

The history of technical analysis in the US started a little while, in the late nineteenth/mid-twentieth century. The most credited work has come from the gathered compositions of Dow Jones prime supporter and supervisor Charles Dow, who was additionally the pioneer of the Dow Theory. A hypothesis that has been based on all through late many years and now frames the premise of current technical analysis.

Key Definitions and Philosophy of Technical Analysis

Before we get more inside and out of the technical analysis, we must characterize what is unmistakable. In this guide, we will hold that technical analysis is the analysis of market action, principally using charts to figure future price patterns. The expression "market activity"

incorporates 3 principle wellsprings of data accessible to professionals: price, volume, and open interest (open interest is just used in futures and options markets).

There are 3 premises at which point technical analysis is based:

Market Action Limits Everything

The assertion "market action discounts everything" shapes the premise of technical analysis. Numerous different standards follow this thought. What it implies is essential that anything that can affect the market price (fundamentally, politically, psychologically, and otherwise) is reflected in the market price. For example, if a price rises, it should imply that the request exceeds supply at the end of the day. On the other hand, if the price falls, it should mean that supply exceeds demand. In this manner, an analysis of price action is always necessary.

An expert doesn't accept that knowing the reasons why the price rises or falls is fundamental. That may appear to be fairly outrageous, and this is the specific motivation behind why numerous traders like to utilize a mix of technical and fundamental analysis.

Technical experts accept everything from a company's fundamentals to broad market components to showcase brain research areas now evaluated into the stock. This perspective is consistent with the Efficient Markets

Hypothesis (EMH), which accepts a comparable price decision. The solitary thing remaining is the analysis of price movements, which technical analysts see as the result of market interest for a specific stock in the market.

Prices Move in Trends

Another reason that is vital to technical analysis is that prices move in trends. That is, a price moving is bound to persevere than to switch—the whole movement following techniques predicated on riding a current trend until it gives indications of inversion. Assuming prices didn't move in

directions, there would be no reason for examining price patterns by any stretch of the imagination. That is, as all price movements would be random and unpredictable.

Technical analysts anticipate that prices will display drifts, even in random market movements, paying little heed to the period being noticed. As such, a stock price is bound to proceed with a past trend than move unpredictably. Most technical trading strategies depend on this assumption.

History Repeats the Same Thing

Another supposition in technical analysis is that human instinct doesn't change. Along these lines, since market action depends on human psychology research, history will generally repeat the same thing. Thus, there is a lot of things we can gain from market history and analysis.

Technical analysts accept that set of experiences will, in general, repeat itself. The redundant idea of price movements is frequently ascribed to market psychology, which will be truly unsurprising depending on feelings like fear or excitement. Technical analysis uses chart patterns to analyze these feelings and ensuing business sector movements to get trends. While numerous types of technical analysis have been used for over 100 years, they are as yet accepted to be important because they delineate patterns in price movements that frequently repeat themselves.

Chart Construction

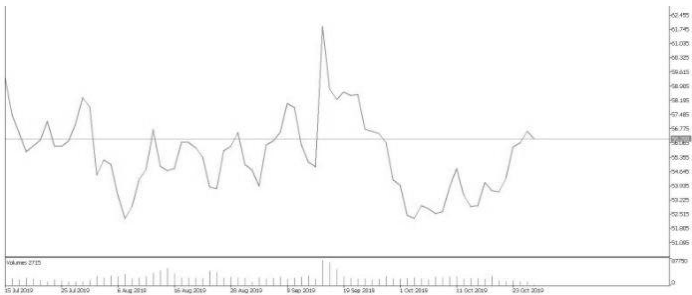
This part is intended for individuals who are new to chart movement. We will be looking at how 3 sorts of charts are developed and how they portray similar data. We will likewise examine volume and open interest.

The Line Chart

The most fundamental chart and quite possibly the most generally used one is the line chart. Since closing prices are of outrageous importance to chartists, the line chart associates closing prices and

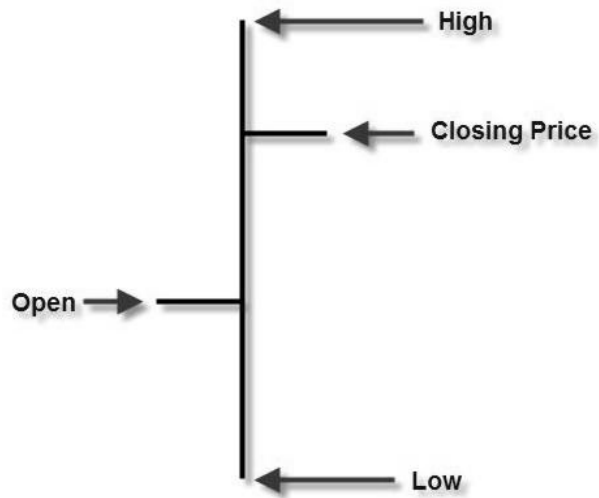
makes them into a continuous line. The line chart is one of the least demanding to understand charts.

In any case, it additionally does not have a ton of data. We just know where the price has closed, yet don't have a clue where it has gone. 2 other chart types assist us with getting this data. Those are the bar chart and the candle chart.



The Bar Chart

The bar chart passes on more data than the line chart. Notwithstanding, it is likewise more hard to peruse. The accompanying chart shows the critical metrics of a bar chart:



As should be obvious, the full scope of the price movement is the length of the upward line. The base mark of the upward line is the low of the reach, while the top is the high of the reach. Likewise, the flat left-pointing tick shows the initial price, while the right-pointing tick shows the end price. The open and closing prices show the everyday range without the spikes in prices. These are significant attributes because not the entirety of the time the end price of the last bar is the initial price of the following bar, as is with the line chart. Once in a while, there are gaps in charts and they portray that the price has opened at an unexpected price in comparison to the past closing price. The chart underneath shows the bar chart inside a similar time range for a similar instrument as in the past line chart.



Notice how there is an enormous hole in the chart. That is something you would not see on a line chart since all price focuses are associated with a line.

The Underlying Assumptions of Technical Analysis

There are 2 basic techniques used to analyze securities and settle on investment decisions: fundamental analysis and technical analysis. Fundamental analysis includes analyzing a company's fiscal summaries to decide the reasonable worth of the business. In contrast, technical analysis expects that a security's price mirrors all openly accessible data and, therefore, centers around the measurable analysis of price movements. Technical analysis endeavors to understand the market

estimation behind price patterns by searching for patterns instead of dissecting a security's fundamental attributes.

Charles Dow delivered a series of publications discussing technical analysis hypotheses. His works included 2 fundamental presumptions that have kept on shaping the structure for technical analysis trading:

1. Markets are efficient with values representing factors that influence a security's price
2. Even random market price movements appear to move in identifiable patterns and trends that tend to repeat over time.

How Technical Analysis Is Used

Technical analysis endeavors to conjecture the price movement of for all intents and purposes any tradable tool that is for the most part subject to powers of market interest, including stocks, securities, futures, and money sets. Indeed, some view technical analysis as fundamentally the analysis of market interest powers as reflected in the market price movements of a security. Technical analysis most ordinarily applies to price changes. However, some experts track numbers other than price for pattern, trading volume, or open interest figures.

Across the business, many patterns and signals have been created by specialists to support technical analysis

trading. Technical experts have additionally built up various trading frameworks to help them figure and trade on price movements. A few indicators are centered around distinguishing the current market pattern, including support and resistance zones. In contrast, others are centered around deciding the strength of a pattern and the probability of its continuation. Ordinarily used technical indicators and charting signals incorporate trendlines, channels, moving averages, and momentum indicators.

Chapter 2. Basic Concept of Trend

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aders often say, "the trend is your friend."

If a given trend has become established, you can piggyback it in whatever direction it's going. And generally, traders only trade with the trend. So, if a trend is going up, you only trade bounces, and if it's going down, you'll

generally trade it by going short (that is, selling stock to take advantage of the dips). The idea is that even if you don't execute your trade particularly well, the trend will help you out and usually ensure you don't make a thumping loss.

A trend is quite simply a direction of price movement. For instance, prices may be trending upwards. That doesn't mean you'll get a price rise every day, but it means that the price will tend to rise over time. For instance, in an upwards trend, you might have closing prices for a bit more than a couple of weeks that went something like; 50, 52, 51, 51, 54, 53, 56, 56, 57, 56, 59,

60, 59. You can see that sometimes prices are up, flat, or even down, but they are moving up on the whole. That's a trend—a general direction. There will be oscillations within the trend, but the trend itself remains unchanged. That means that you can trade these oscillations within the trend; as long as the trend continues, if you buy when prices are trading lower than the trendline, and sell when they're above the trendline, you'll make money. Trend trading strategies are very common and can be nicely profitable.

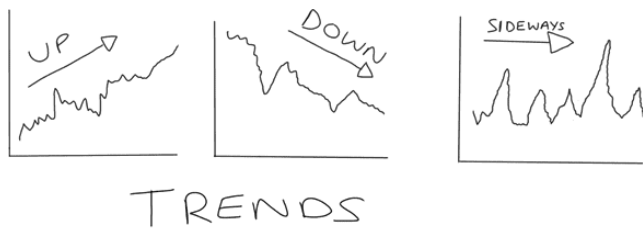
Trends often reflect a certain market sentiment—that is, if investors feel the economy is doing well, earnings are going up, the future will deliver better earnings still, there will probably also be an uptrend. But trust what you see on the chart, not what you see in the newspapers or on the bulletin boards.

I also need to give you a warning. Traders also sometimes say, "Is it a trend or will it bend?" That's why in the technical analysis we need to be able to recognize trends, but we also need to be able to recognize signals telling us that trends are about to end or even reverse.

The Trend Has 3 Directions

Okay, this is pretty simple. In the words of "those magnificent men in their flying machines," there are 3 directions:

- Up
- Down
- Flying around—or what traders call “sideways.”



If you know the lyrics of the song, up and down are exciting—UP-tiddly-up-up and DOWN-tiddly- down-down—and the “flying around” or “sideways bit” is not really emphasized. It's the same on the stock market. Up and down will make you money. They're good strong trends. Sideways, also known as “ranging” or “consolidation,” can be a big problem, and a market with a sideways trend is hard to make profits in. (On the other hand,

when you get a breakout from a sideways trend, you'll notice!)

You'll see many times throughout the book some of my handout slides—yes, they're all drawn with my interactive whiteboard pen, but the good thing about the slides is that I've removed all the

distractions that you get on a regular share price chart. No dates, prices, moving average lines, volume bars, whatever—just the trend!

A proper uptrend has increasing highs, but it also has increasing lows. And while a downtrend will hit ever-increasing lows, it should also see each bounce achieving a lower and lower level. Sideways, on the other hand, price movement can be anywhere—sometimes within a really tight range, sometimes just looking chaotic on the chart with prices all over the place.

Technical analysis can help you identify trends and give you good reliable signals when a trend is coming to an end.

The Trend Has 3 Classifications

As well as 3 directions, the trend has 3 classifications or time zones:

- **Short-term trend:** Less than 3 weeks.
- **Medium-term trend:** A few months.
- **Long-term trend:** 6 months to 1 year.

Each market has its typical way of defining these 3-time classifications. Futures markets such as commodities futures tend to have shorter timescales, and equity investors have longer timescales, but you'll get the feel of whichever market you trade in after a while.

A short-term trend can be part of a medium-term trend, and a medium-term trend can be part of a long-term trend—in other words, trends can come nested inside each other. Within a long-term bull market (a market in a long-term uptrend), for instance, the S&P may have shorter-term uptrends separated by short-term downtrends—rallies and dips. A longer-term investor who is a less active trader may see a continuing uptrend, where you, as a shorter-term trader, can see a pronounced short-term downtrend.

You might use different trends as different signals.

-
- **Long-term trend:** Okay, there's a trend here, so this is a stock I want to look at. And it's a long-term uptrend, so I will generally be buying stock when I think there's a medium-term uptrend.
 - **Medium-term uptrend:** This gives me my profit expectation. Suppose we're trading low in the long-term trend, I can guess where the stock price should be headed within that trend. For instance, in a long-term trend where the recent high was around \$62, and it looks like if it continues it would get to \$65 quite easily, and the price is now \$56, I have a \$9 a share profit potential (and \$6 profit potential if the trend fades).
 - **Short-term uptrend:** This gives me my timing. So I've got that medium-term trend in mind, but when is the best time to get in? When I see a real short-term tick up that says to me this is the right time to initiate that short position.

Some people like to look at super long trends, like the idea of Kondratieff waves and 40-year cycles, but those are outside the scope of this book.

Support and Resistance

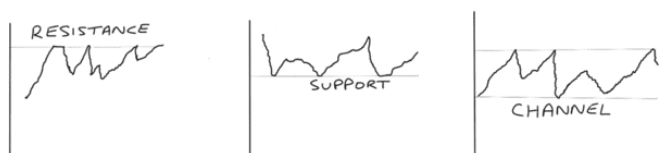
The trends we want to look at go up and down, and so do their trendlines. But we can also draw some really

important straight lines on the chart, and these are called support and resistance lines.

You'll often see a share price exhibit a particular pattern of nearly getting to a price and then refusing to go any further. It's a bit like watching a child playing at the seaside, running down the beach towards the sea, but as soon as a wave comes, running back up the beach squealing happily so their toes don't get wet. Share prices behave just the same way!

A share price might keep falling to a particular price but then rising back again—that's a support line. It's likely that if the share price approaches that line, it will bounce off it again, so this supports the price. On the other hand, a share price might keep testing a high, but it never crosses that level—

that's a resistance line, and the chances are, if it gets to it again, it'll not manage to maintain enough momentum to push its way through.



Here you can see my handouts. I promise you I had not been drinking when I made this one! See how the share prices just touch the resistance and support lines. (A channel has a resistance line at the top and a support level at the bottom—you can make some neat short-term trades inside a well-established channel, but the most profitable trades you'll make are on breakouts—which we'll talk about later.)

For instance, look at the way in the chart below. The AT&T share price in the second part of the chart keeps coming up to \$29.50 and just falling back again. At the beginning of January 2021, it gets from \$28-29.25, but it doesn't manage to stay there. Then it gets to \$29.75 about 25th January, and then it falls off, then it gets there again about 17th February, and again, it falls off. That's a resistance line, a kind of tidemark. You could put a ruler on the chart and draw it across, and there you have your resistance line.



Now the stock has finally managed to push through to \$30. It has actually gone through the resistance line... but I'm not sure I'm convinced. I'd want to see another indicator confirming that.

But there's another interesting thing; it does look as if the stock has formed a support line, too. Have a go at guessing where it is—and I'm going to give you a clue, again you'll be looking at the more recent half of the time period. Can you draw a straight line which the price approaches, but won't go through? I reckon it's at about \$28. Look, it's there just before that bit spikes up, then it falls back to it after the spike, then again at the beginning of March, and every time it bounces.

Now the support line is interesting because it says if I buy at \$29, I probably only have 1 dollar downside, and I know that if the share price goes below \$28, then it's time to take that loss and get out.

Why do support and resistance levels work? One reason is “anchoring,” the way that certain information gets stuck in our minds. Investors and traders often remember the price they bought or sold at, and a lot of investors say, “I’m not going to sell till I get my money back.” If a lot of them bought at \$52 and the price went down temporarily to the mid \$40 levels, then when they see \$52

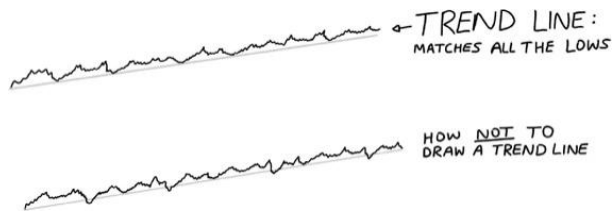
again, they'll sell—which by the rules of supply and demand, will cause the price to stop rising. That's a resistance level in action.

The more times a share price unsuccessfully tests a support or resistance line, the stronger that support or resistance becomes. Buying close to support or selling close to resistance makes a good trade, as you'll capitalize on the bounce. But you'll want to put a stop-loss just below a support line (or above resistance) to make sure that if there's a breakthrough, you cut your losses and make a quick exit.

By the way, if a share price does break through a resistance line, that old resistance line will now become a support line. And if a share price breaks through a support line to the downside that support line will now function as a resistance line preventing the price from rising past it.

Trendlines

It's not always easy to see the market trend. If there's a lot of price movement, you may be able to see that the market's in an uptrend, but not how steep the slope is or how fast prices are rising. You're seeing all the noise, and that makes it difficult to see the signal—the real trend.

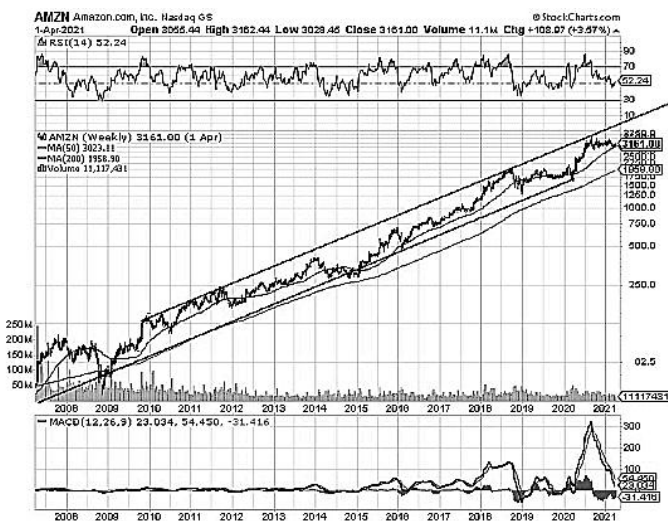


Drawing trendlines on the chart can help you visualize the trend. Basically, if the market's in an uptrend, then you're going to try to find a line that it keeps coming back to at the bottom. Find the lowest points that the price hits, and join them up. You are lucky. The software will do it for you—

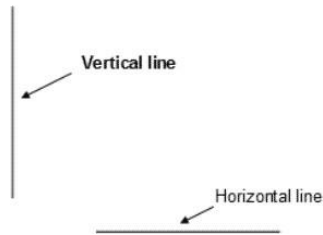
or at least help you do it—whereas this was a pencil-and-ruler job well into the 1980s. So, what you should have is a chart that now looks as if all the peaks are “sitting” on a line of support.

For a market in a downtrend, you're going to do things differently. You're going to draw a line that goes through the highest highs—the places that the price gets to when it bounces, but then runs out of steam and falls back.

Okay, with support and resistance, I showed you my hand-drawn pictures first. This time let's jump right into the real world and look at Amazon. I went on StockCharts and I just couldn't believe what a great example of a channel I'd got, so I stuck it into my drawing software and put in the trendlines—the real trendline is the straight one underneath, that's pushing it upwards, but you can also see there's a straight resistance trendline at the top. (The other 2 curvy lines are Moving Averages, which we'll cover later on.)



A trendline shows you very clearly the direction in which the market is moving and the speed of the move. It also acts as a support of the resistance line; for instance, in a downtrend, if the price goes towards the trendline (which is above the price bars), then you're getting to a decision point where it will either fall back again or make a breakthrough.



What you're doing is not very different from drawing support and resistance lines, but you're trying to get a slope instead of a horizontal line. The chart we just looked at is horrible for trying to draw a trendline, although it's got good support and resistance, so let's try something with an uptrend.



Here's Realty Income, where you have quite a lot going on, but I want you to look for one very clear uptrend. Just look at the candlesticks and ignore the other lines on the

chart for the moment. But this is the kind of thing you'll see when you open a charting package—this one comes from StockCharts—and you need to get used to focusing on the lines that matter first, and then to look at the rest. Get some practice by grabbing a straight edge and trying to find the line of best fit—

that's the trendline. (The trendline is not shown on this chart, you have to draw it yourself—but if you want to see a live visual demonstration on how to draw a trendline correctly, then I would recommend you watch my free bonus companion masterclass, as that covers this topic in a lot more detail to help your understanding.)

You see from the dip in the share price in early 2021 (down to 11th January) that it quickly establishes an uptrend, and if you draw a line under the lows, although it heads higher, and then back, it doesn't break the trendline, it keeps bouncing back from it and making higher highs (that is, every little spike goes higher even if it falls back a little in between) all the way through January and the first part of February. Let's assume you got in around \$58 in mid-January because you waited a little while to be sure it was a real uptrend; the stock would have gone to \$63 (around 14th February) before finally breaking the uptrend by dipping to about \$61 towards 18th February. That's \$3 a stock profit, or 5% in about a month. You might have done a bit better than that, of course, if you didn't wait for the sell signal, but got out nearer to \$63 a few days earlier.

One way of thinking of the share price is that it's connected to the trendline by a rubber band. It can get further and further away from the trend, but the stretchy rubber band will generally keep pulling it back. If it hits the trendline, it'll usually bounce. But as it gets close to that trendline, you're going to want to watch out—this is a

dangerous time, and it's also, for some traders, an opportunity, as there could be a breakout.

Occasionally you might need to redraw a trendline. It may become steeper or it may, on the other hand, become less steep as price rises decelerate. That doesn't necessarily mean the trend has ended. However, when an uptrend becomes very steep, that could suggest the kind of manic frenzy that often accompanies a market top, so beware of trading in such conditions and keep an eye out for bearish signals (that is, signals telling you the price is going to fall) such as a drop in momentum or moving averages.

Trend Channel

We already saw how if you connect up the highs and the lows, you can create a wide bar with roughly parallel lines, as we did with Amazon. These 2 lines define the trend channel. I actually like trend channels a lot as a way to trade, but you do need practice in drawing them properly.

There are several things you need to know about trend channels:

- The longer a channel continues, the stronger the trend. (Remember that Amazon trend! Over a decade of it!)
- If a trend channel is combined with a strong trading volume, it's more reliable than if trading is weak.
- If the price breaks out of the channel, it is likely to move quite significantly in the direction it has now established.
- A narrow channel doesn't give you much room for trading—if a stock is always trading within about 2% of the trend that limits your potential profit. On the other hand, a wide channel, where the stock has some volatility within the overall trend, gives you a chance of larger profits.

If you get a good horizontal channel, running all the way across the page instead of up and down, this is one of

the few times it's worth trading a stock that is not in an uptrend or a downtrend. You may have a stock where, for instance, a certain level of dividend yield means income investors tend to buy whenever it comes down to the bottom of the range, and sell when it gets to the top—you don't need to know the reason, just trade the channel. Buy at the bottom of the channel, sell at the top.

Channels are also really useful for setting your stop-losses and profit expectations. If you buy at the bottom, you're looking to exit at the top, but you should also set a stop-loss just below the bottom of the channel. If you've got it wrong, that stops you from being caught by an unexpected breakout.

By the way, you can even sometimes see from a channel how long the share price usually takes to move from bottom to top of the channel. That gives you a good idea of how long your trade will last so you can time it nicely!

Besides simple price channels, there are other kinds of channels, which use volatility rather than price indicators, such as Bollinger bands. But for the moment, let's just stick with the price channel; that's quite enough to get your head around!

Now go and find a few stock charts, and see if you can spot some price channels. See how many times the price bounced around within the channel and work out if you could have made a profit by trading it every time the price touched, or nearly touched, the bottom line.

Divergence

Remember, "Is it a trend or will it bend?" Divergence is one way to tell.

Now so far, we've talked about trends, channels, and support and resistance. You can make nice profitable trades by using them as your guide. But sometimes prices break out of their trends.

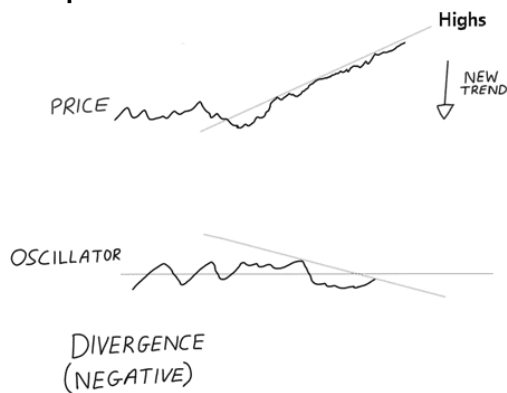
There are quite a few reasons that might happen. For instance, you sometimes see that if a stock gets promoted to a major market index, and big investment funds and Exchange Traded Funds have to buy the stock

because it's in the index. Or a stock might have a profit warning which the market wasn't expecting, and the price goes way below the range. Or a war might break out, or there could be unexpected political news that drives the markets higher or lower. You might also see the end of a big investor exiting their position—for instance, with some IPOs, the end of a lock-in period may see some of the sponsors, founders, or management selling out. Or it may happen "for no reason."

Well, the reason is really that every time the trendline was tested before, there were buyers or sellers at the right price to send the stock back up. And this time, there weren't. And if that's the case, that

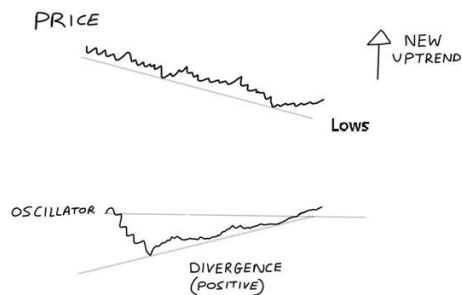
quite likely reflects a slight change in market sentiment, and there are a few ways you could pick that up before the breakout. That's where divergence comes in.

When you're looking at your price chart, use a momentum or a trading volume indicator (like an oscillator) running beneath it. (We'll take a good look at those and the way they work later—for the moment, don't worry about what they mean, just look at the pictures.)



Usually, you'll see the 2 lines run pretty much in the same direction most of the time. But if you have an uptrend, and the oscillator is headed downwards, that's a negative divergence and it suggests that the uptrend might not continue.

On the other hand, if the price just made a new low, but the momentum indicator is headed up, that suggests prices might rise—positive divergence.



What you're seeing in the case of negative divergence is that while the price trend looks as if it's continuing, it is decelerating or falling behind the market. So, that's an indicator that your price trend isn't as strong as you think it is. But you don't need to pay attention to it all the time—just if:

- Your price is hitting new highs/lows
- You think you've got a double top or bottom forming (and we'll talk about those later).

To check if you really have divergence, connect up the highest highs, or lowest lows, and connect up the lines for the indicator for the same period—joining highs to go with price highs and lows to go with price lows. If the slopes are the same, great. If they're moving in opposite directions, you have divergence.

Divergence is not a signal—it doesn't tell you to trade. But it is an alert—that is, when you see divergence, if you're risk-averse, it's time to exit your position, and if

you're a risk-on kind of person, it's time to stick close to your trading screen and watch that stock like a hawk.

Chapter 3. Recognizing Breakout

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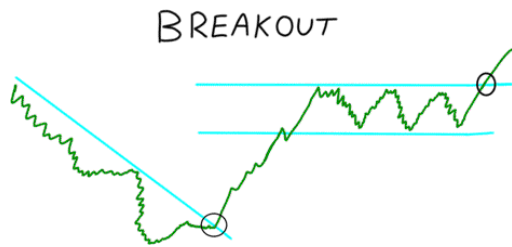
o far we have talked about trading within a range. That can be really profitable and it can also be quite a low-risk, low-effort form of trading if you identify the right stocks and keep an eye on the patterns.

But if you want to hit the big time, you want the runaway profits that come with a breakout. Remember that "ball on a rubber band" idea I used when I talked about the share price and the trendline? What happens when the rubber band breaks? The ball goes way, way up into the air (or, of course, if we're talking stocks, it could also go in the other direction)—that's a breakout! Compared to trading the range, trading a breakout is like jumping on a train when it's already started moving.

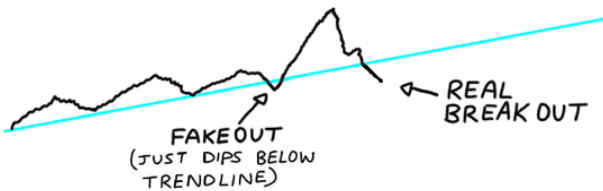
Just so you know: A breakout can happen in either direction, up or down—it's simply breaking out of a pattern.

A breakdown, on the other hand, only goes down.

Breakout



A more technical description of a breakout is that it's when a stock price moves outside an established channel, support, or resistance line, with increased volume. (The increased trading volume is required to show that it's a real breakout and not just a fluke.) Breakouts move to the upside, and they move fast.



A genuine breakout is a big, bold move. If you're looking at a candlestick chart, you'll see a big-bodied candle closing well above the resistance level. If all you see is the price just poking over the edge of the resistance level, that's not a real breakout—it's a fakeout. If you see the price getting near to the resistance line, but it hasn't gone through it yet—it's a fakeout. Wait for the line to be broken before you trade.

Note by the way that a breakout can happen even in a bear market, that is, a market that is in a major downtrend—there won't be so many breakouts to trade, but stocks that have the strength to move against the market are stocks that should really get going once they start, so you will still get that speedy rise.

Your signal is simple—it's the first time that the price breaks out of the channel, or breaks the resistance line,

and closes above it.

How do breakouts work? One way they work is what's called a lockout rally. Imagine you have a well-known stock that had bad results for a couple of years, it's taken a bit of action, and it's stopped going down but it hasn't begun to move up yet.

Everyone is thinking it will soon be time to buy it again, but they haven't bought it yet; they're waiting for something. And for whatever reason you get a little buying—maybe one brave fund manager, maybe a couple of brokers getting in—and it goes through the line, and now all those people who haven't bought it have a massive feeling of FOMO (which, as if you didn't know, means Fear of Missing Out). It's motoring, so it must be time to buy, so they buy, so it goes up a bit more, so more people buy...

At that point, of course, the short-term traders are already getting out with their profits!

How to Find Breakouts

If you're looking for breakouts, you won't find them. What you're looking for is the pre-breakout pattern. You're looking for stocks that are trading in a fairly narrow channel, that are trading in a really boring way—almost so the candlesticks fill the channel. You're looking for stocks that are range-bound. That is, stocks that are stuck in a range, which keep bouncing from top to bottom and back again without ever going anywhere. This kind of build-up is absolutely classic. It's like a pressure cooker—when it goes, it's going to explode.

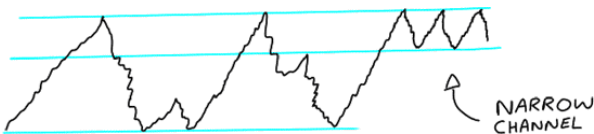
You can also look for stocks that are close to their 52-26-week highs—this information is easy to find on any finance site. If stocks are trading at a high for the period,

they're also going to be close to a resistance level or close to the top of the trendline. That means they'll either be close to a fall back down again into the channel, or they'll be ready to break out. By looking for stocks that are close to a high, you've cut out all the stocks that are not really going anywhere much, so you've reduced the number of charts you need to look at before you find a good breakout pattern emerging.

Of course, you can also look for stocks close to 52-26-week lows. That might catch the “bouncers.”

Draw your resistance lines on the chart—even if they were the last hit some time ago—and keep monitoring those stocks every time the price gets towards that resistance line. Use a volume indicator too—the best stocks for a breakout are those that haven't traded in great volume. You're

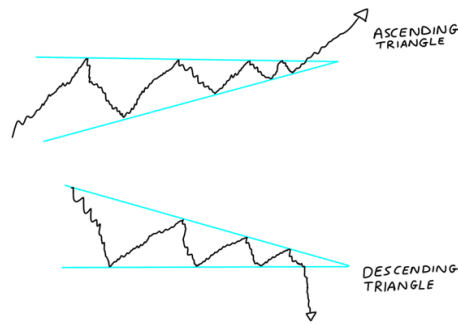
looking for a market where investors have got bored, and they're not doing much—when you get the breakout, that's when they will get interested again! Then you will see the volume accompanying the share price move, which is how you know it's for real.



Another good potential configuration is where you see a resistance level that has been repeatedly tested by sharp spikes. You're looking for the share price to make big spikes, to make a big jump to test the resistance level, and then for it to fall back really steeply. You don't want to see gentle waves; you want to see a spiky mountain landscape of strong rallies that quickly reversed. Or if you're a beach bum—you want to see big surf, not nice gentle waves. These spiky, punchy price movements show that the resistance level is a good strong one. It's as if the share price took a real run-up, but it still couldn't punch through the wall. So that's a tough wall, and any breakout that makes it through the resistance will be a massive one. The bigger the breakout, the more money you'll make on the trade. Further good signs that a breakout could be coming are:

- The channel grows narrower.

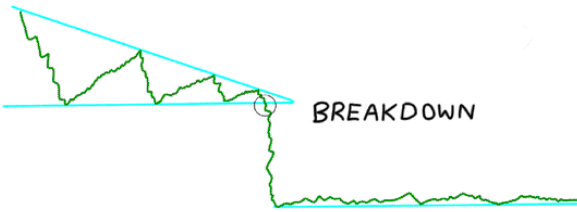
- A build-up period in which prices form a tight cluster.
- Trendlines which make an ascending triangle—the lows are getting higher, but the highs have been on the same trendline.
- The resistance level has been tested unsuccessfully several times.



The longer the build-up, the bigger the breakout. Once you've found your targets, plan your trade in detail before any breakout. I'm going to talk about trading tips later—but you should always plan your trade so that when the breakout comes, you can act real fast. Remember, breakouts are fast.

What do you do if you miss a breakout? If it was preceded by a really good consolidation period (trading within a limited price range) and has made a definitive move to the upside, you should jump in even though you're a bit late. Or if it looks as if it's a pretty small breakout, you could wait for the price to test the line that was the old resistance level and has now become a support level, and you could buy it then. Happily, you do quite often get a second chance!

Breakdown



What's a breakdown? It's just a breakout, except that the share price goes down instead of up. So it will usually be announced by a descending triangle in some cases—lower highs, but the lows are

forming a horizontal line. Like a breakout, it's usually on high volume and will lead to a large price swing and, usually, into a new downtrend. It can often be very quick, which is why you need to set up your trendlines and then monitor them whenever you see a potential breakdown trade setting up.

Looking for a breakdown by just looking at loads of charts is like looking for a needle in a haystack. On the other hand, if you have collected half a dozen charts that show tight consolidation build-ups and descending triangle trendlines, you pretty much know that one is going to show up—but you have to be ready to act when it does. (That might mean actually watching your screens, but it could also mean setting up stop-limit orders with your broker and just letting them run.)

However, taking advantage of a breakdown isn't as easy as trading a breakout because you need to be able to short trade or trade options. Not everyone is happy trading short. (There's a subsection on this coming up.)

If you do go short, the best way to set up the trade is to put a sell stop-limit order just below the support level. That is an order, which specifies a price at which the order becomes valid, and a price limit after which it is no longer valid (e.g., "Sell 100 IBM if the stock price falls below 90 but not if it goes below 95). It's a good way of entering a breakout or breakdown trade. But if there is high volume and a lot of price action, you might not get your order filled. So waiting for a retest (or another

chance) of the trendline that has now become a resistance level might give you a better price—if, of course, there is a retest. You can never be sure.

Think about that for a second; the moving average shows the average of prices for the last 20 days, let's say. As the share price falls quickly, it will fall below the moving average, because the moving average still has all the higher prices from previous trading days in it. As long as the price is still falling quickly, that will continue to be the case, but the moving average will eventually catch up once the fall decelerates. At this point, the stock might rebound, but even if it doesn't, the easy gains are gone and you can find a better trade elsewhere.

Channel Break—Some Trading Tips

Let's look at a typical channel break and see how to trade it. Technical analysis will give you good trading ideas, but you also need to learn how to trade. And if you haven't been involved in the stock market before, or if you've always been a buy-and-hold investor making simple market buy orders, you have a lot to learn.

First of all, you need to work out your profit target, and this will probably (though not always) also be your exit point. This is something buy-and-hold investors never bother with. It's easy with a channel break, though; look at the width of the channel, and if it's \$6, then add \$6 to the price at the resistance line, and that's your immediate profit target. If you're trading a round lot (100 shares), that's a total \$600 profit.

Your goal should be to stack the odds in your favor, so usually, I like to see a stop-loss order that's half the size of the expected profit if the trade works. In this case, that would be \$3. If the stock falls to \$3 below the resistance line, you're out. You've lost \$300. This seems like a reasonable balance to me, risking \$300 against \$600 with a good chart formation that has something like a 70% probability.

In fact, let's just multiply the probabilities to see how good it is:

- $\$600 \times 70\% = \420
- $\$300 \times 30\% = \90

So, if I'm right about that probability, then I have an expected value of $\$420 - \$90 = \$330$. It's positive. But even if the probability was only half—now come on, do the numbers. It's still a good chunky positive number. What we calculated here was what statisticians call the expected value of all the probabilities, and you need this number to be a positive one. If it's negative, what you're making is not a trade but a gamble.

Don't just set the trade and run away. Keep monitoring it. In particular, you should be watching the volume indicator—if this is a genuine breakout, then you'll see the sellers coming in and the volume

increasing. So you might get to your original exit point, and say that having reconsidered the situation, this looks like a massive breakout. In which case, set a new stop-loss order, and you might even decide to scale in, that is, increase your position by buying more shares.

But if you do scale-in, remember to reset your stop-loss order. With a breakout into a bullish trend, you may have this setup:

- You entered the position at \$70
- Expected profit \$6 (using the channel range) = \$76 share price
- So, the stop-loss order is \$3 = $\$70 - \$3 = \$67$
- The price quickly gets to \$73, you can see a lot of volume in the market, so you decide to scale in. If you keep your stop-loss order at \$67, your potential extra profit is \$3 (from \$73- 76), but your potential loss is now \$6 (\$73 all the way down to \$67).
- So, you need to pull your stop-loss order up higher, to say \$71, so your expected return is still greater than your possible loss.



Also, remember how we talked about different lengths of a trend? A breakout could just be one breakout in a series. Look at the chart of Mattel above, and you'll see that there are 3 series of consolidation/build-up phases, tight channels of trading, followed by breakouts. Can you draw the rough trendlines and work out the dates? (C'mon, this is what you're going to be doing every day as a trader.) Okay... Consolidation from late January to the middle of April, then a breakout (or breakdown); more consolidation till the middle of June when there's another breakout; then more consolidation through July, with a bit more volatile price action this time, and then a breakdown just before the beginning of August.

If you're a long-only trader, this chart is no good for you. But if you can go short, whether your broker lets you sell short (and effectively "lends" you the stock for the meantime), or whether you can take out options, then this is a great chart. It's particularly good because you have these short-term big steps down. Going short costs money, and options have expiry dates—so you're looking for shorter-term trades as well as simply going short.

The first breakout in mid-April went from \$25 to \$21, then the second one in June went from about \$22 to \$20. But the third one in late July started at \$21, and the downtrend ran all the way to below \$15 by mid-September. The final breakout in mid-November leads to a severe downtrend in December. If you'd made good money on the first breakout, you might

have said, "Right, I'm done with that stock." You would have been wrong. There were another 2 good chances to make almost the same profitable trade, and the last was the best.

Hey, what was that gap up in November 2017 though? Apparently, the stock had got so low that there was talk of bigger toy company Hasbro buying it, and the stock jumped—but as you can see from the end of the chart, nothing happened.

The “gap” by the way is when prices open above the previous day’s closing price, with nothing in between. You'll quite often find it relates to corporate news, whether that's a takeover rumor, as here, or an earnings surprise.

Short Selling

If you want to make the most of breakdowns, you're going to need to be happy short selling or using instruments that allow you to replicate a short sale.

Basically, short selling is selling a stock you don't own. It's as if you promised to deliver a new smartphone to a friend of yours, anticipating you can get it at money off on Black Friday. You charge your friends 10% less than the retail price, you get the phone at 40% off, and keep the change (though possibly not your friend). Short selling allows you to make money out of a forecast that a price is going down. If you'd shorted Nasdaq just before the tech crash, you'd have made a huge return, but a lot of traders just take 4-5% on each of their shorts.

The risk, of course, is if you'd sold your friend the smartphone at 10% below retail, then found out that the version they want has just had a price rise and isn't in the Black Friday sale, you'd lose money because you'll have to buy it at retail and they're still going to want that 10% off.

Shorting is not that easy to do as a retail investor—institutional investors like big mutual funds, pension funds, or hedge funds, and bank trading desks, make more use of it, often for portfolio protection rather than trading purposes. However, there are a few ways you can go short in the market.

If you have a margin account with your broker, and permission to short, your broker will “lend” you the shares in your margin account and then sell them on the market on your behalf. You will at some point either close the trade at a profit, close it at a loss, or possibly have to pay a margin call to keep your trade going if it's out of the money at the time (which is why you need a tight stop- loss order).

For the market as a whole or for individual sectors, you could buy an inverse ETF (exchange-traded fund). This kind of fund delivers the reverse of the market return, so if the market goes down, the ETF goes up. You buy and sell them just like you buy and sell a share, and they are low-cost funds,

so you won't lose a load of entry commissions like you would with a mutual fund. This is my preferred choice if I see a good short trade in the S&P, for instance.

You can also use options. Frankly, there is a whole lot of very specific knowledge that you need to trade options—for instance, they come with expiry dates, so their value varies according to the time you have left as well as the price of the stock. Unless you are mathematically minded and willing to get to grips with the specifics (and take a look at the Black-Scholes formula if you're tempted), leave them alone.

Finally, you could use something called a Contract for Difference (CFD), unless you're in the US or Hong Kong. However, you may find in other jurisdictions they are only available to certain investors—professionals, high net worth individuals, and those who can display a high level of market expertise. Frankly, I would avoid them till you've got several years of profitable trading behind you. Even then—be careful. Please, let me emphasize that while stop-losses orders are important for all trading, they are especially important if you go short. If you buy a stock at \$600 and it falls, the most you can ever lose is \$600 a stock. That's it. Wipeout. But your house, your car, your collection of Pokémon cards, none of that's on the line. Nor are your other stock positions. I have been completely wiped out on 1-2 stocks (both, as it happens, involved corporate fraud), but I lived to tell the tale.

On the other hand, how high can a share price go? \$100? Higher. \$500? Higher. Tesla has been as high as \$900. Want more? Berkshire Hathaway trades at \$380,482.75. There is, effectively, no limit to how high a share price can go. That means if you go short, there is no limit to the amount you could potentially lose. You could lose your shirt—your house, your savings, the rest of your portfolio, the lot.

So, if you go short, make sure you have your trades thought through in advance, including your stop-loss order, and don't let anything prevent you from using that stop-loss. That stop-loss could just save your life.

False Breakout

This is the biggest problem with breakout trading—there are simply too many false breakouts. And that's one reason I've emphasized probabilities and stop-losses because not every breakout trade will work, so you need to minimize the impact of the fakeouts. That's in contrast to trading within a channel, where your profits will be more limited, but you have a slightly better probability.

This is why you need a good trading strategy—you'll need to maximize your profits and make sure that you control any losses very tightly, because the win/lose ratio is probably not going to be as good as with range trading.

One indicator you need to look at is volume, and there's actually one in particular, which is useful for breakouts—Volume Weighted Moving Average (VWMA). In the case of a fake breakout, it won't do much at all—in the case of a real breakout; it will accelerate upwards, giving you confirmation that you've made a good trade. VWMA also gives you your exit level, as once the price falls below the VWMA—indicating that the balance between buyers and sellers has tipped—you have exhausted the short-term profit potential of the trade.

It's worth keeping an eye on the news pages by the way. If a breakout happens along with fundamental news, such as a positive earnings surprise or a new product

launch, it's probably a real breakout—and some serious institutional funds may back it.

Plus—don't give up! This could be part of the consolidation, the build-up—the last unsuccessful test of resistance before the real breakout. Patience is well rewarded.

Stop-Losses

Set your stop-losses tight for breakouts. If a breakout reverses, it could be fast and hard. The ideal for a breakout, though, is that if you've read the signals right, it should make money from the moment you enter the trade.

So, most traders put a stop-loss order just below the resistance line. If the price falls back here, it could fall away pretty sharply back into the old trading range, so stop yourself out of the trade. But remember that stocks will often retest the level they have just broken within the first few days, and then rise again—so don't set your stop-loss order at or above the resistance line, just a bit below. Only take your loss if the stock closes the day below the line.

Chapter 4. The 4 Types of Indicators You Need to Know

A

n indicator is a mathematical computation based on a stock's price and/or volume. The outcome is utilized to forecast future prices. Technical indicators are used broadly in technical analysis to forecast changes in stock trends or price patterns in any traded asset.

Indicators are calculations based on the price and the volume of a stock (security) that gauge such things as money flow, trends, volatility, and momentum. Indicators are utilized as a secondary measure to the actual price movements and add extra information to the analysis of stocks. Indicators are utilized in 2 major ways: to validate price movement and the quality of price patterns and to create buy and sell signals.

There are 2 main sorts of indicators: leading and lagging. A leading indicator precedes price movements, giving them a prognostic quality, whereas a lagging indicator is

a verification tool because it chases price movement. A leading indicator is believed to be the strongest in periods of non-trending trading ranges (sideways), whereas the lagging indicators are still helpful during trending periods.

There also are 2 kinds of indicators based on its construction: those that fall under a bounded range and those that don't. Those that are bound within a range are referred to as oscillators—these are the foremost common sort of indicators. Oscillator indicators have a range, for instance between 0- 100, and signal periods where the stock is oversold (near zero) or overbought (near 100). Non- bounded indicators still form buy and sell signals in conjunction with showing weakness or strength, however, they vary in the manner they do this. The 2 major ways that indicators are utilized to form buy and sell signals in chart analysis are through divergence and crossovers. Crossovers are the most popular and are mirrored when either

the price cross over the moving average or when 2 different moving averages cross over one another. The second way indicators are utilized is through divergence, which occurs when the price movement of an asset and the indicator are both moving in opposite directions. This hints to indicator users that the current price trend is weakening.

Indicators that are utilized in chart analysis provide an awfully helpful source of additional information. These indicators help out determine volatility, momentum, trends, and several other aspects in a security to aid in the chart analysis of trends. It is significant to note that while some traders use a single indicator exclusively for buy and sell signals, they are best employed in conjunction with chart patterns, price movement, and other indicators.

Simple Moving Average (SMA)

A simple moving average just takes several periods—say 10 days (which is 2 working weeks); it adds together the closing price for each day and divides by 10. So it's the average price of the stock over the last 10 days. You can calculate it over any period—20 days, 200 days, 1 year (though 1 year is probably not very useful for a trader). Or rather, you can get a chart package to calculate it for you, these days.

Why do we use simple moving averages? We use them to take the “noise” out of the chart so that you can see the trend more easily. The idea is similar to trendlines, just a bit differently executed. But you should look at SMAs together with the price chart because it's when you put the 2 together that you get the best information—and when you use 2 SMAs together, you can also get some interesting information.

For instance, when the price dips below a moving average, that's a sign that the stock might be breaking downwards. In this sense, an SMA can be treated a little like a resistance or support level. As a rule, in an uptrend, the price should be above the moving average—if it breaks down, this

could be a strong signal that prices are shortly going to head downwards. But it's not got the best probability, so check with another indicator before you do anything about it.

Another way of using moving averages is to take 2 averages of different lengths and to look for a significant crossover. All technical traders have their favorites; some like to use the 10 and 20 days MAs, others prefer 50 and 200 days, longer-term averages.

When the shorter-term MA crosses over the longer term, it gives you a bullish signal—the “golden cross.” It's telling you that over the shorter period, on average, share prices have been trending higher than over the longer term. You might not see that so clearly from the actual price line if the prices reported have been volatile. If the short-term MA crosses to the downside, you have a “death cross.” Prices are trending lower. That could be a good sell signal.

The problem, of course, is that while moving averages clarify what's happening, because the majority of a moving average is made up of older price data, they have a built-in time lag. And if a stock is trading in a range, in a fairly choppy way, you may find that the averages keep crossing over without delivering you any real information.

Important points of simple moving average (SMA) are:

- It is a moving average of the stock price based on the time period and it acts as strong support and resistance.
- A buy signal is generated when the closing price of a candle moves above this moving average. A sell signal is generated when the closing price of a candle dips below the moving average.
- The most common SMA used are 20, 50, 100, and 200 time periods.



The above figure shows 20 SMA, the average price movement of 20 days.

In order to access this indicator, a trader can go to the trading platform (example: Tradingview). Click “Indicators,” and then type “Simple Moving Average.”



Relative Strength Index (RSI)

The relative strength index (RSI) is a momentum indicator used to evaluate overbought or oversold conditions. It is perhaps one of the most well-known oscillators used by traders. Developed by Welles Wilder, the RSI is a momentum oscillator that measures the speed of the changes in price in any given timeframe. In plain English, the RSI tells us how quickly the price is changing at the moment. Just like the Stochastic oscillator, the RSI hovers between 0-100. Unlike the Stochastic though, there are clearly defined overbought and oversold levels. Generally, a reading above 70 is considered overbought and below 30 is oversold. These levels generate entry signals but, just like the Stochastic, divergences, centerline crossovers, and other types of divergences generate signals as well.

It is necessary to highlight here once again that this indicator is not infallible. It must be used in conjunction with other indicators, preferably those which measure trend strength and direction, to confirm readings. Many traders are quick to dismiss indicators because they do not understand this concept and instead expect the indicator to provide an infallible entry time after time. The markets do not work in this manner and if you let go of this expectation it will do wonders for your results as well as your peace of mind.

Now that that's out of the way, let's dig deeper into understanding how this number is calculated. The RSI has 3 basic components: the average gain, the average loss, and relative strength. The default lookback period of the RSI is 14 as recommended by Wilder but can be changed by the trader based on their needs. The RS component is calculated as follows:

- $RS = \text{Average gain} / \text{Average loss}$

The RSI itself is calculated

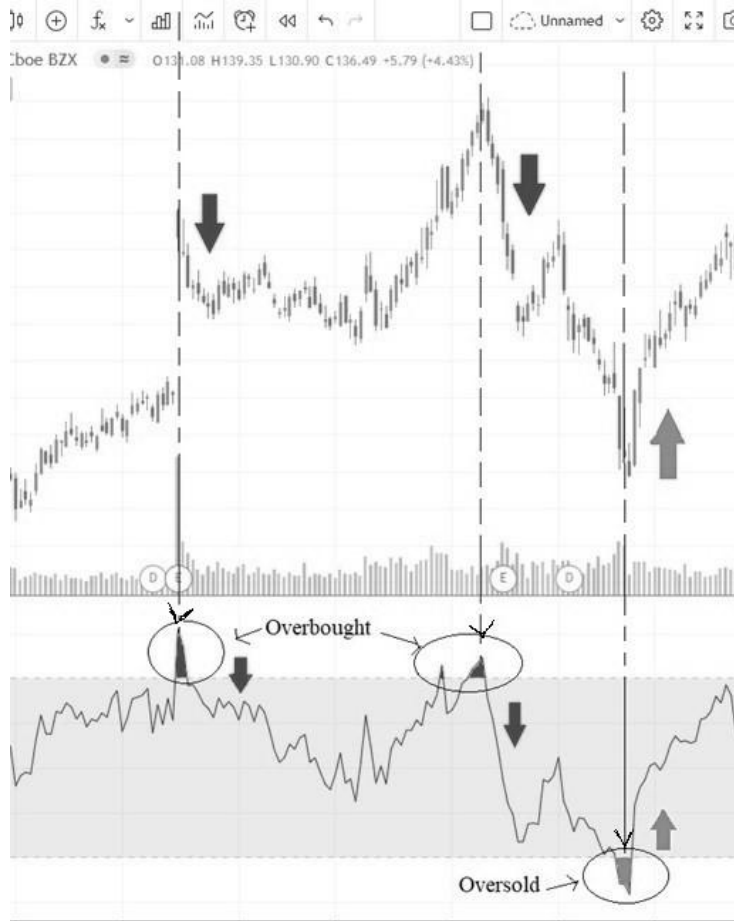
as follows:

- $RSI = 100 - (100 / (1 + RS))$

Important characteristics of the RSI are:

-
- RSI is usually used on a 14-day timeframe with 70 and 30 as high and low levels respectively. The region above reference level 70 is considered as overbought and the region below reference level 30 is considered as oversold.
 - If the RSI is in the overbought region, a correction or a pullback is likely to occur.
 - If the RSI is in the oversold region, a bullish reversal is likely to occur.

Investors usually buy a stock when the RSI is in the oversold region and sell a stock when it is in the overbought region.



RSI is the curved line shown in the figure above.

Note: The RSI can sometimes stay oversold or overbought for days and it should only be used in conjunction with other indicators to determine the probability of a reversal in direction.

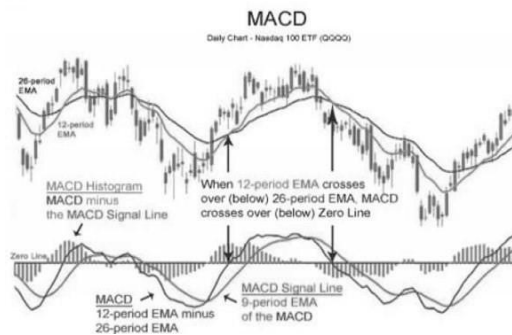
MACD Indicator

This is one of the most popular and used indicators in chart analysis. MACD is a trend-following momentum indicator that demonstrates the connection between 2 moving averages of prices. The MACD is merely the difference between these 2 moving averages plotted in opposition to a centerline. The centerline is the point at which the 2 moving averages are equal. Together with the MACD and the centerline, the EMA of the MACD itself is plotted on the chart. The thought behind this momentum indicator is to gauge short-term momentum compared to long-term momentum to assist signal the present direction of momentum.

MACD = Shorter run moving average - Longer run moving average

When the MACD is positive, it indicates that the short-run moving average is higher than the long-run moving average and recommends upward momentum. The opposite holds true once the MACD is negative—this indicates that the short-run is below the long-run and recommends downward momentum. Once the MACD line crosses above the centerline, it indicates a crossing in the moving averages. The most general moving average values employed in the computation are the 12-day and 26-day exponential moving averages (EMA). The signal line is generally formed by using a 9-day EMA of the

MACD values. These values can be adjusted to satisfy the requirements of the technical trader and the security (stock). For more volatile securities, shorter-term averages are employed whereas less volatile securities must have longer averages.



Another side to the MACD indicator that's usually found on charts is the MACD histogram. The histogram is drawn on the centerline and delineated by bars. Every bar is the difference between the MACD and the signal line or, in most cases, the 9-day EMA. The longer the bars are in either direction, the more momentum behind the direction during which the bars point (see the figure above).

Interpretation

There are 3 general methods employed to interpret the MACD:

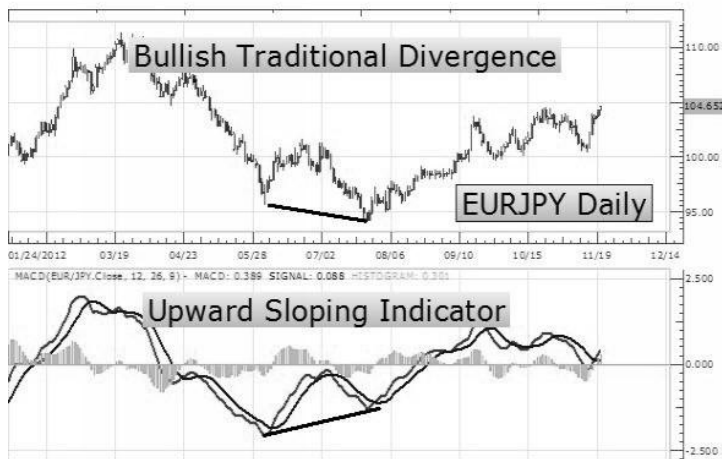
- 1. Crossovers:** As shown in the chart above, once the MACD falls below the signal line, it's a bearish signal, which signifies that it may be time to sell. On the other hand, once the MACD rises higher than the signal line, the indicator offers a bullish signal, which recommends that the price of the security is probably going to experience upside momentum. Several traders wait for a confirmed cross higher than the

signal line before stepping into a position to evade getting faked out (stepping into a position too early on), as shown by the primary arrow.

- 2. Divergence:** When the stock price diverges from the MACD. It indicates the end of the present trend (see the figure below).

3. Dramatic rise: Once the MACD increases severely—that's, the shorter moving average pulls far away from the longer-run moving average—it's an indication that the stock is overbought and will shortly come back to normal levels.

Traders as well watch for a move below or higher than the zero line because this indicates the position of the short-run moving average in relation to the long-run average. Once the MACD is higher than zero, the short-run average is higher than the long-run average, which indicates upside momentum. The opposite holds true once the MACD is lower than zero. As you can see from the chart above, the zero line usually acts as an area of resistance and support for the indicator.



The chart shown above is an example of bullish divergence in MACD.

On-Balance-Volume (OBV)

This is a momentum indicator that utilizes volume flow to forecast changes in the security price. The OBV metric was developed by Joseph Granville in the 1960s. He considered that, once volume raises sharply without a major change in the security's price, the price will sooner or later jump upside and vice versa. It's also one of the simplest volume indicators to calculate and understand.

The OBV is computed by taking the entire volume for the trading period and allotting it a negative or positive value based on whether or not the price is down or up throughout the trading period. Once the price is up throughout the trading period, the volume is allocated a positive value, whereas a negative value is allocated once the price is down for the period. The negative or positive volume sum for the period is then added to a sum that is accumulated from the beginning of the measure.

It is significant to focus on the trend in the on-balance volume (OBV)—this is more vital than the actual value of the OBV measure. This measure enlarges the fundamental volume measure by joining volume and price movement.

Interpretation

The theory behind OBV is relied on the difference between smart money—specifically, institutional investors—and less complicated retail investors. As pension funds and mutual funds begin to buy into an issue that retail investors are selling, the volume could increase even as the price remains comparatively level. Finally, volume drives the price upside. At that time, bigger investors start to sell, and smaller investors start buying.

The OBV is a running total of volume (negative and positive). There are 3 rules employed when computing the OBV. They are:

1. If today's closing price is less than yesterday's price, then: $\text{Current OBV} = \text{Prior OBV} - \text{Today's volume}$
2. If today's closing price equals yesterday's price, then: $\text{Current OBV} = \text{Prior OBV}$
3. If today's closing price is more than yesterday's price, then: $\text{Current OBV} = \text{Prior OBV} + \text{Today's volume}$



Chapter 5. Continuation Patterns

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At some times during a particular trend, the most predominant movement pauses for so many reasons. One of such reasons is that as the trend continues, long buyers will begin to sell with the mindset of making a profit. With this, there is bound to be buying pressure which causes the price to drop.

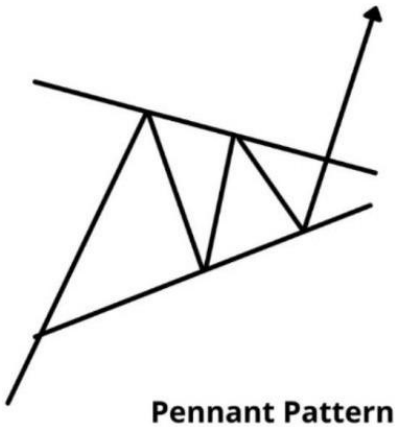
A synth of this selling and buying pressure leads to sideways price action. Contrarily, a chunk of downward movement sparks short selling to take over, thereby causing buying pressure to counter the downtrend. Note that market trends happen all the time in all markets to create recurrent patterns on charts.

This pattern can, therefore, be defined as a pause in the middle of a predominant trend when the bulls gather momentum in an uptrend or when the bears catch their breath for a while amid a downtrend. As a price pattern forms, traders can't possibly tell whether this is going to

be a continuation or reversal so they must pay keen attention to the trendlines. This is to understand the price pattern to know if the price falls below or above the continuation line. The best practice that has worked for me so far is to assume that the trend is going to continue until a reversal is confirmed.

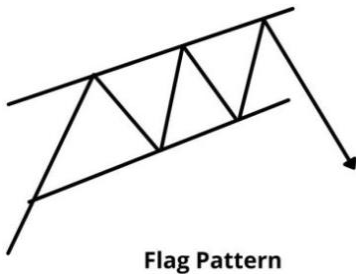
Generally, when a price pattern takes longer to form, the price movement within such a pattern will also take a long time to take shape, the movement is bound to be a significant one once the price breaks either below or above the continuation zone.

Pennants Pattern



A pennant pattern is typically forecasted by a sudden price rise. It is an almost vertical rise in prices that is also known as the flagpole or the mast. The 2 trend lines that come together to form the pennants pattern are down trend lines which stand for the no-so-highs. They can also be upward trend lines that stand for the lesser lows. A pennant pattern that forms after a sharp downward move tends to keep sliding downwards and can be seen as a bearish pennant, while the pennant that forms after a sharp upward trend will be taken as a bullish pennant. It is important to note that pennants usually appear around midway through the whole price movement so any move that follows the breakout of the pennant will carry the same weight as the flagpole.

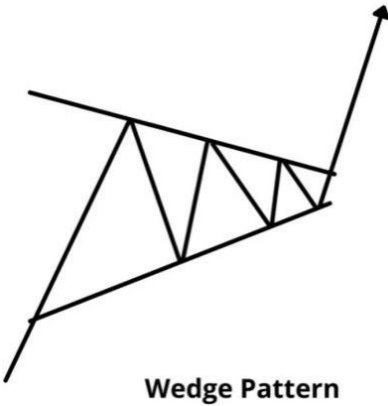
Flag Pattern



Flags come to life after 2 parallel slopy parallel trend lines come together in either an upward, downward, or sideways/horizontal movement. Generally, when a flag is in an upward slope, it shows as a pause in a market downtrend. This means that a flag that aligns itself downwards portrays a break in a market uptrend. In most cases, when the flag forms, it is followed by a decline in volume which picks up as soon as the price breaks away from the flag formation.

The flag pattern in a market chart has the shape of a sloping rectangle which has support and resistance lines that are parallel until a breakout happens. The breakout typically comes in the opposite direction of the trendlines. This means that the flag pattern is a reversal pattern.

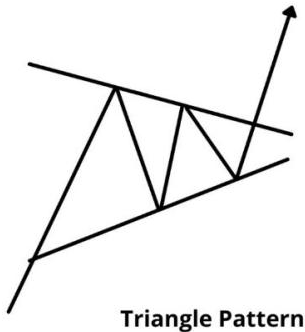
Wedge Patterns



The wedge pattern stands for the tight price movement that stands within the support and resistance lines which may either be a rising or falling wedge. Unlike what is obtainable with the triangle pattern, the wedge pattern does not include a horizontal trend line, but it is either marked by a couple of upward or downward trend lines.

When the wedge is a downward one, it means that there will be a price break in the resistance line. An upward wedge, however, indicates that the price will break from the support line. This, however, proves that the wedge is a reversal pattern because its breakout is in contrast to the general trend.

Triangles

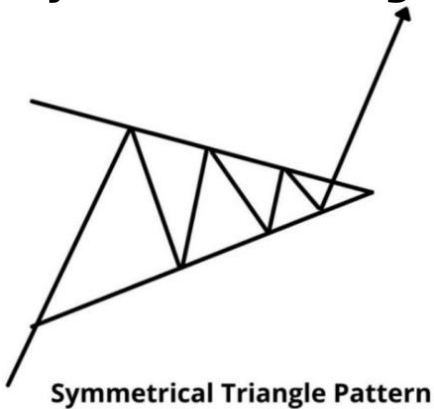


Triangles are some of the most popular price patterns you'll come across in technical analysis because you are likely to come across them more than every other pattern. The most popular triangles are the ascending, symmetrical, and descending triangles. These patterns can stay for as long as weeks to many months.

For triangles like symmetrical triangles, they happen when 2 trend lines come together facing each other to indicate that a breakout is about to happen. It doesn't show direction. Ascending triangles on the other hand can be identified by their flat-up trend line and their rising low-trend lines which indicates that a high breakout may happen. The up-trend lines in descending triangles indicate that there might be either breakouts or breakdowns. The weight of either the breakdowns or the breakouts usually stands at the same height as the triangle's left vertical side.

Let's go deeper into understanding the 3 types of triangles one after the other:

Symmetric Triangles

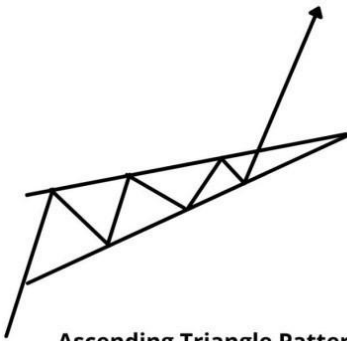


Symmetric triangles come to life following the meeting of the connecting lines of the highs with the trendline that links the lows, such that it forms a triangle. These patterns are marked by a down trendline as well as an up trendline that comes together.

Because the 2 lines of the ascending triangle are marked by the same slope, it isn't quite possible to predict its direction. In most cases, there is a possibility of a breakout from one direction or the other. One can't tell which direction it will be. The direction of the triangle is also neither upward nor downward and this is because the slope of the 2 lines reflects one another.

The role of this pattern is to tell traders that the existing trend before the formation of the pattern will continue even after the price breaks away from the triangle.

Ascending Triangle

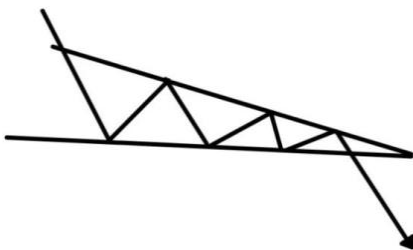


Ascending Triangle Pattern

This pattern is characterized by a flat line that accompanies the highs that remains at almost the same price as well as an up-trend line that follows the higher lows. In a nutshell, this trend indicates that the highs will remain the same while the lows increase.

When this pattern appears, it means that buying pressure is more than the selling pressure which will eventually end in a breakout at the upside.

Descending Triangle



Descending Triangle Pattern

The descending triangle pattern can be likened to an upturned ascending triangle. This means that rather than facing up, it faces down.

This pattern is birthed by a flat slope at the base of the trendline as well as a sharp downward slope above the trendline. The descending triangle pattern indicates that sellers are taking over from buyers and forcing prices to decline. It is a bearish continuation pattern that forecasts a downward breakdown as soon as the pattern breaks.

Rounding Bottom



The rounding bottom pattern, which is also known as the cup, forecasts a bullish uptrend. The middle of the U shape presents traders with the opportunity to buy by taking advantage of the bullish trend that comes after the breakthrough from the resistance levels.

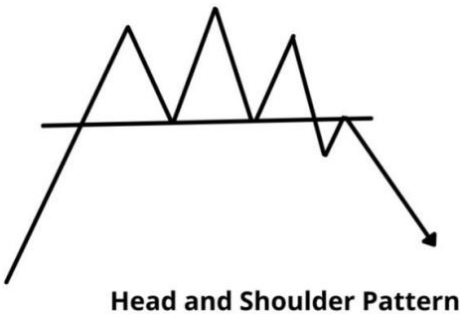
Gaps

Gaps are usually formed after a space within 2 trading periods as a result of a notable boost or decline in prices. A security can, for example, close at \$10.00 and open at \$12.00 after some earnings or other contributors.



Gaps are categorized into 3 distinct types which are the runaway, breakaway, and exhaustion gaps. While runaway gaps are formed at the middle of a trend, breakaway gaps form at the beginning of the trend. Exhaustion gaps on the other hand form somewhere close to the end of the trend.

Head and Shoulders Pattern



The head and shoulders pattern forms to forecast the transition from bull to bear market reversal. This pattern is marked by a big peak which has 2 other small peaks at both sides. The 3 levels in this pattern drop to the same support level after which it is expected to break out in a downward movement.

This pattern may form at the top or bottom of the market in a series of 3 different pushes. The first is known as the initial peak or trough, while the second one is the larger one. The third push takes the form of the first one.

When there is an interruption in an uptrend by the head and shoulders pattern, it is most likely followed by a trend reversal which eventually leads to a downtrend. Contrarily, when a downtrend leads to the heads and shoulders bottom, it is likely to culminate in an upward trend reversal.

It is not unusual for horizontal or sloppy trendlines to form, then connect the peaks and the troughs which reflect within both the head and shoulders. There may be a decline in volume as the pattern is formed. The volume, however, springs up as soon as the price breaks above the head and shoulders bottom or below the top of the head and shoulders on the trendline.

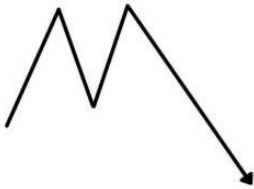
Double Bottom



Double Bottom Pattern

This pattern is the reverse of the double top pattern. It takes the shape of the letter “W” and shows that the price has tried to break through the support level at 2 different times. This is a reversal chart pattern because it indicates a price reversal. After the 2 unsuccessful attempts at breaking through the support line, the market moves towards an upward trend.

Double Top



Double Top Pattern

This is the opposite of the double bottom pattern. It takes the shape of the letter “M” and falls into the reversal trend after 2 failed attempts at pushing through the resistance level. The trend eventually falls back to the support base, then begins a downward trend which pushes through the support line.

Both the double tops and bottom patterns signal at the points where the market tried to push through the support or resistance level twice without any success. The double top on the other hand is marked by the previous push up to the resistance level which precedes a second failed attempt then culminates in a trend reversal.

Summarily, price patterns form after prices take a pause. They point towards those areas where there may be a consolidation that would either result in a reversal or a continuation of a dominant trend. Trendlines are

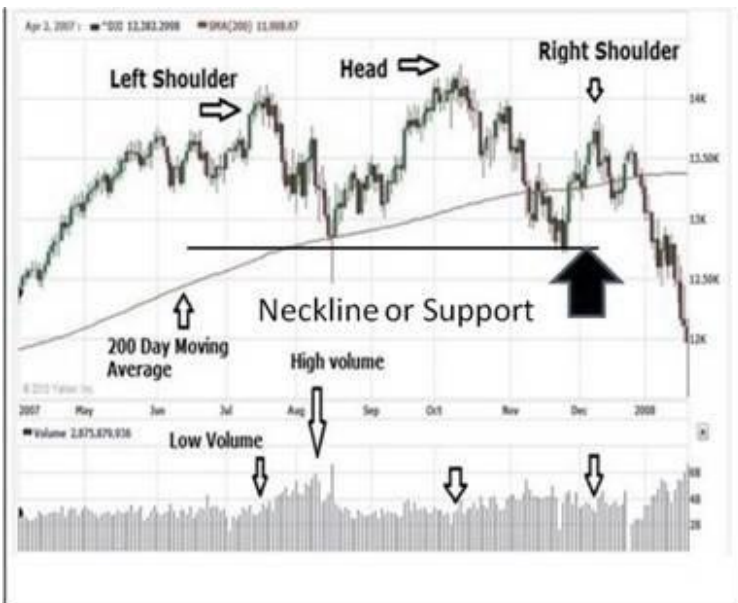
particularly important aspects of understanding these price patterns as they can appear in different forms like double tops, flags, cups, or pennants.

Volume is also another especially important aspect of this pattern. They usually decline as the pattern forms, then increase when there is a price breakout from the pattern. As a technical analyst,

you should be able to use price patterns to predict future price trends which would include both continuations and reversals.

Chapter 6. Reversal Patterns

The Head and Shoulders



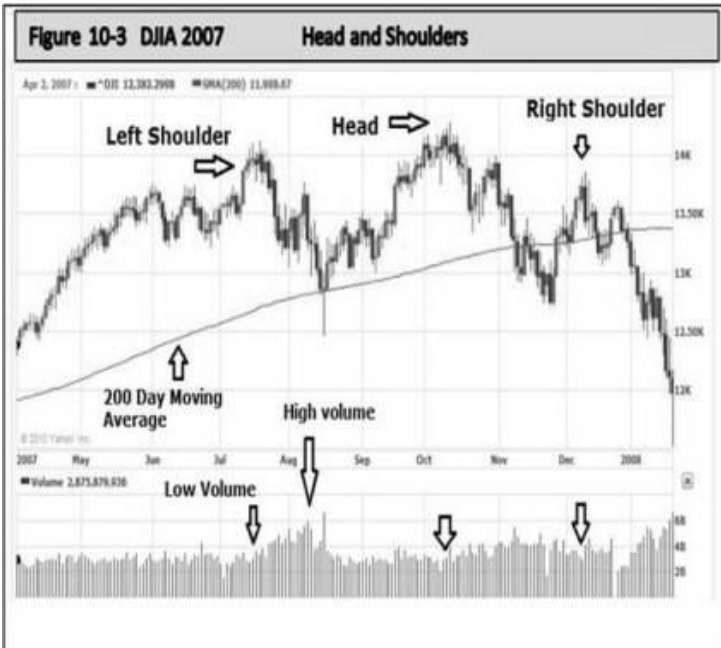
The head and shoulders is one of the best known and probably the most reliable of the reversal patterns. A head and shoulders top is characterized by 3 prominent market peaks.

T

While the peak, or the head, is higher than the 2 surrounding peaks (the shoulders), as this pattern was forming, your original trend and/or channel

line would have been headed upward and would have been on the low after the first shoulder was formed. That trend line would have been broken after the head was formed and the ensuing low was reached. A new trend line would have had to be drawn that now is actually the neckline, which is drawn below the 2 intervening reaction lows. Remember, the preceding upward trend was already broken when the second low was reached, and now a close below the neckline completes the pattern and signals an important

market reversal. Let's take a look at a head and shoulders reversal that started a bear market which led to a severe market decline. See the figure below.



By the way... Does the above chart look familiar? Yes, this is a chart of the Dow Jones Industrial Average during the all-time-high set in October of 2007. And as you remember—that was the beginning of a major bear market. First of all—Look at the clear head and shoulders pattern. The left shoulder was the first high. Then the head is the all-time-high. Then the right shoulder is the third high, also called the third “peak.” This is a classic head and shoulders pattern.

When you see one of these forming whether it is on an individual stock, index fund, or in this case, the Dow Jones Industrial Average, it is time to “sit up and pay

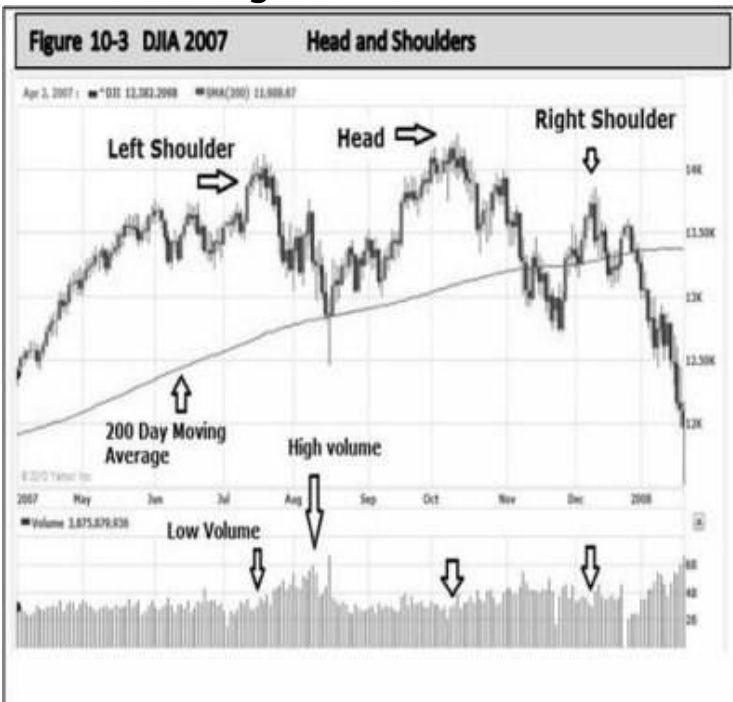
attention!” This formation is one of the most reliable chart patterns you will see.

How do we know that distribution was underway after the first peak? Volume. The heavy volume during the pullback after the high on the left shoulder is our first clue. Look at the increased volume during that pullback. It tells us there was heavy selling, and, it tells us the volume was not

confirming the uptrend that had been in place. For volume to confirm the uptrend, you want to see higher volume during advances and lower volume during pullbacks.

Let's take a closer look at the volume, and how volume must confirm the trend.

See the figure below.



When looking at the volume across the bottom of the chart, as the first high formed (left shoulder), the volume was a little higher. Normally that is good. It is nice to see a stock, or in this case, the market, make a higher high on increased volume. But during the sell-off after the first high, the volume was higher than the volume of the advance while making the high. Thus, distribution...

Now, notice the volume on the all-time-high (head) is decreased volume. This is more distribution. The volume is not confirming the trend. The volume then increases on the next pullback. Inexperienced buyers are scooping up the stock and the pros are happy to sell. Make no mistake,

distribution is always a result of the pros selling (distributing) their shares to the uninformed, the novices, the unsuspecting, and yes, the pigs that are greedy and hoping for more of an advance.

Now, look at the volume on the third high (right shoulder). Yep, we're in trouble now! The pullbacks and sell-offs after each high were on increased volume. Thus, more and more distribution, and more lambs being led to the slaughter. More dumb money listening to TV Talking Heads claiming all sorts of brainless prophecies.

At this point, the market is still trading above support levels. No major concerns, right?

At about this time you probably became dreadfully tired of the "Talking Heads" on every financial news network proclaiming all sorts of things. Personally, I remember hearing some who claimed that the DOW could, and should, reach 20,000. Do you think the ones claiming this had just purchased stocks "hoping" for further advance in the market? Maybe... Or they may be selling and want to keep the buyers coming so they can unload.

Let's also apply a little common sense. When the high at the first shoulder is reached, the DJIA is about 1,000 points above the 200-day moving average. Once again, when the head (all-time high) is formed the DJIA is about 1,000 points above the 200-day moving average. Who sees this and realizes at the very least there is most likely going to be a pullback or correction and begins selling?

Yes, the smart money, the experienced traders. Sure, some might not sell out completely, but will certainly cut back and/or go to cash to preserve most of their profits. At the very minimum, tightening up the stop loss would be the smart thing to do. Simply, a stock, or the market, will normally not trade too far above the 200-day moving average for a long period of time before declining back closer to the moving average. In this instance, the market is 1,000 points above the moving average, so a decline should be expected.

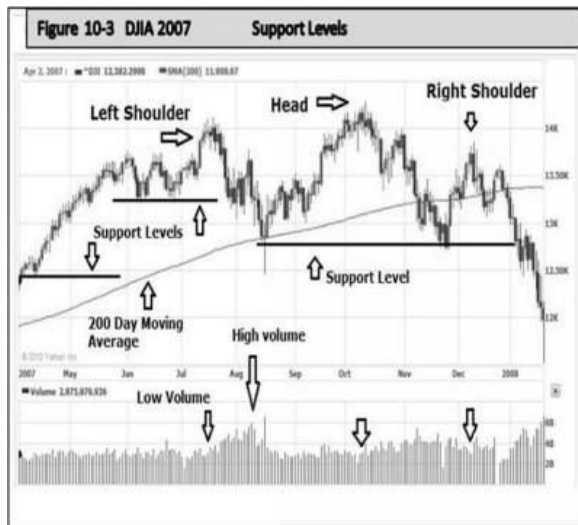
Now, think risk vs. reward. Would a seasoned investor be buying a top? Would a smart investor be chasing the market, realizing there has been a long-term advance, buying in, and hoping it will go

higher? No! The risk of a correction is too high, and, the chance the market is going very much higher is very low. As a chartist, you can apply this knowledge to every investing and trading decision you make. For instance, before entering the market, you have to ask yourself:

- What is the market currently doing?
- Where is the market in relation to the moving averages?
- What does the volume tell you?
- What is the risk/reward?
- Are you buying a bottom or are you chasing the market?
- How do you protect your investment capital?

Every time you purchase an investment, your money is at risk. Therefore you must always make sure you are purchasing at a time when the risk is low, the reward is high, and your money is protected.

Let's look at support levels. Support levels are very important. We always want to know where support may be in case of a decline. (See the figure below.)



We see that there were only 2 support levels of any significance during this distribution phase. One was minor support just prior to the left shoulder and then there is the more significant support where the pullback landed on the 200-day moving average. The next significant support is found after the all-time high. These 2 significant support levels are what is considered the “neckline” on this pattern. The decline following the left shoulder top took about 30 days to find support and move higher to eventually form the highest peak, the head. That support level was tested and held prior to the right shoulder formation. But once that second support level was broken, a dramatic decline ensued. This is because the break below the neckline is a confirmation of the head and shoulders pattern.

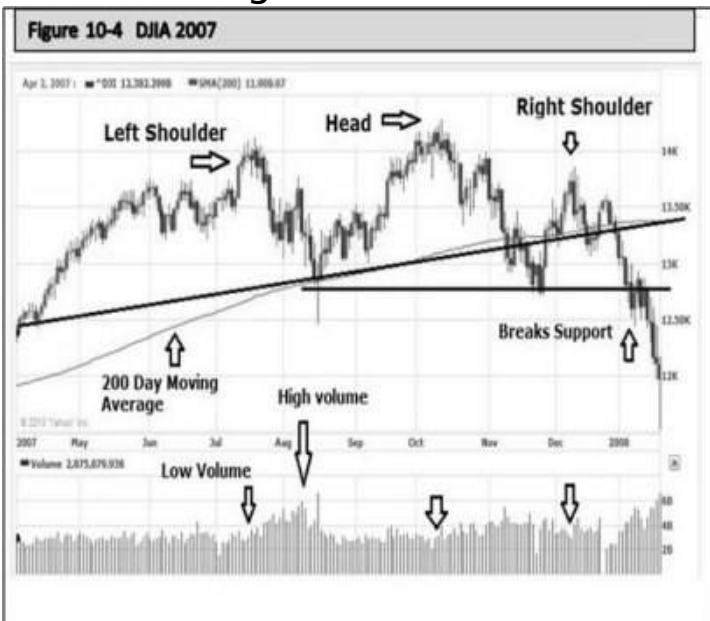
Note again, the volume increased as the market moved past the all-time-high and then past the right shoulder. See the increase in volume on the declines compared to

the volume leading up to the highs? What does that tell you?

For one, increased volume certainly tells us that more stocks are changing hands, more buyers, more sellers, but the increased volume is happening during declines. The volume must confirm the trend. And in this case, the highs are on low volume and the sell-offs are on high volume. Thus

indicating further advance is not likely, and, the volume is confirming the developing trend, a new downward trend. Historically, every market top has experienced the very same signals, warnings, and told the investors what it was about to do. There is always low volume on advances, higher volume on declines, along with trend lines and support broken. This scenario always leads to a new trend with lower highs and then lower lows. The right shoulder in this pattern is the first “lower high.” Let’s look at one more thing using the very same chart. This time I added a trend line.

See the figure below.



As we learned earlier, by connecting 2 or more lows, we can draw a trend line. The 200-day moving average is a trend line that can be added to any chart, and it is about as good as it gets, so to speak. The 200 DMA is also shown on the above chart. Now take note of the volume

when the market broke below the support line. Yes, it was increased volume. Once the market closed below the support, panic ensued. Short sellers piled on.

Yes, a dramatic decline hit. But that can be expected once support is broken. When you think about every decline during the distribution phase for the 6-months prior to breaking support, yes, the pros were selling continually. Not so much to cause panic, but very methodically, and constantly

selling. That is why the volume is low on advances when the market is topping out. The big money is not buying, they are gradually unloading. They wait for a little bounce and then sell into the strength. They are taking their profits. Many have been holding the stocks since they purchased them at the bottom during the previous “accumulation phase.” In this case, that may have been in 2003 after the previous bear market when the Internet bubble burst.

You see, smart money knows that the market doesn't always go up. Anytime the DJIA is 1,000 points above the 200-day moving average, the smart money expects a pullback. There is never any guarantee that a pullback will be just a small correction. Any pullback may turn into a major correction or a bear market with a 30-50% drop. Experienced traders take some money off the table at the tops. There is no sense in allowing a profit to disappear, or worse, turn into a loss.

Also note that after the all-time-high was reached and the head of the pattern was formed, over the ensuing 45 days there were at least 4 big down days where the sell-off created dark engulfing candles. These are very telling! They are your early warning signs. They indicate what is to come.

Moving Average

Moving averages are a very useful tool for determining trends. They can be applied to any chart. When displaying a chart, most will allow you to choose a 10-day moving average, a 20, 50, 100, or a 200-day moving average. The 200-day moving average is the most powerful of all. Whether you are dealing with an individual stock or a market index, when buying, your investment should be above the 200-day moving average (200 DMA). This average historically acts as both support and resistance. Meaning, if the stock or index is above the average, there should be support at or near the 200 DMA. If the stock or index falls below it, then the 200 DMA will usually act as resistance when the stock is trying to advance.

Notice in the above chart, in July of 2007 the first shoulder (peak) was formed, and then the market retreated to support right on the 200 DMA. Then after hitting the all-time-high, it fell through the 200 DMA.

Something significant—Take a look at the candle that formed when reaching the 200 DMA the second time. Do you see how it fell below the 200 DMA then traded higher to close above it? Yes, the following candle was a bearish engulfing candle that clearly fell through the support of the 200 DMA. But think of the psychology of the traders and investors. Many obviously believed there would be support at the 200 DMA and started buying. This buying provided a close above the average. The support of the 200 DMA didn't last, but traders were obviously buying in hopes the support would hold.

The 200 DMA is historically a great tool for the long-term investor. It can be used to signal buy and sell points. Meaning, the investor simply sells out when the security falls below the 200 DMA and waits for the security to cross back above the 200 DMA to reenter the position.

In Summary

Any way you look at the above charts of the head and shoulders formation—any way you analyze it—even pretend that 2008 has not arrived yet, and you are looking at these charts as they form on a daily or weekly basis.

Whether you would have drawn a trend line on the lows leading up to the very first peak (left shoulder), or drawn a support line, or drawn a channel line, used a 100 DMA or a 200 DMA, the result would have been the same.

Once the market broke below the first line of support and then broke the second line of support (neckline), the head and shoulders pattern was formed.

Chapter 7. 24 Candlestick Patterns That Every Trader Should Know

C

andlestick patterns are used to forecast the future course of price movement. Find 24 of the most widely recognized candlestick patterns and how you can use them to distinguish trading opportunities.

What Is a Candlestick?

A candlestick is a method of showing data about an asset's price movement. Candle charts are quite possibly the most mainstream parts of technical analysis, empowering traders to decipher price data rapidly and from only a couple of price bars.

It has 3 fundamental highlights:

- The body, which addresses the open-to-close range
- The wick, or shadow, that shows the intra-day high and low

- The color, which uncovers the course of market movement—a green (or white) body demonstrates a price increase, while a red (or dark) body shows a price decline

Over the long run, singular candlestick form patterns that traders can use to perceive significant support and resistance levels. There are a considerable number of candlestick patterns that demonstrate a change inside a market - some give understanding into the harmony among buying and selling pressures, while others recognize continuation patterns or market hesitation.

Before you begin trading, it's critical to acquaint yourself with the nuts and bolts of candlestick patterns and how they can advise your decisions.

Practice Patterns

Reading

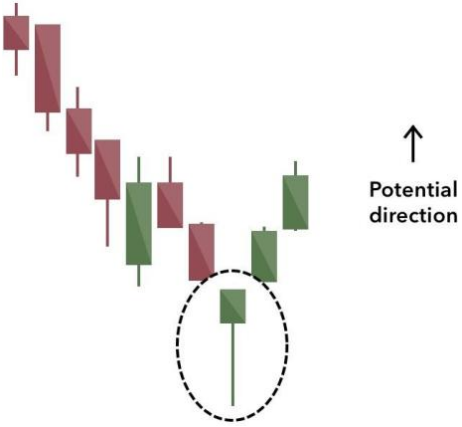
Candlestick

The most ideal approach to figure out how to peruse candlestick patterns is to work on entering and leaving trades from the signals they give. You can build up your abilities in a danger-free climate by opening an IG demo account, or on the off chance that you feel adequately sure to begin trading, you can open a live record today. When using any candlestick pattern, it is critical to recall that in spite of the fact that they are extraordinary for rapidly anticipating patterns, they ought to be used close by different types of technical analysis to affirm the general pattern.

6 Bullish Candlestick Patterns

Bullish patterns may frame after a market downtrend, and signal a reversal of price movement. They are an indicator for traders to think about opening a long situation to profit from any upward direction.

Hammer



The hammer candle chart is shaped of a short body with a long lower wick and is found at the lower part of a descending pattern.

A hammer shows that despite the fact that there were selling pressures during the day, eventually, a strong buying pressure drove the price back up. The shade of the body can shift, however, green hammers show a more grounded positively trending market than red hammers.

Inverse Hammer



A comparatively bullish pattern is the inverse hammer. The only contrast being that the upper wick is long, while the lower wick is short.

It shows a buying pressure, trailed by a selling pressure that was not sufficiently able to drive the market price down. The converse hammer proposes that purchasers will before long have control of the market.

Bullish Engulfing

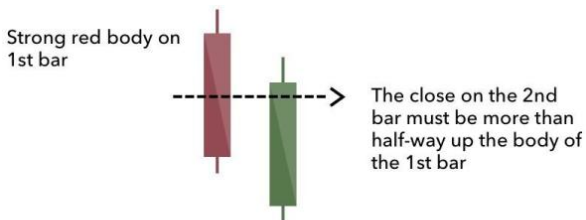


↑
Potential
direction

The bullish engulfing pattern is framed by 2 candlesticks. The main light is a short red body that is totally immersed by a bigger green candle.

Despite the fact that the subsequent day opens lower than the main, the bullish market pushes the price up, coming full circle in an undeniable win for buyers.

Piercing Line

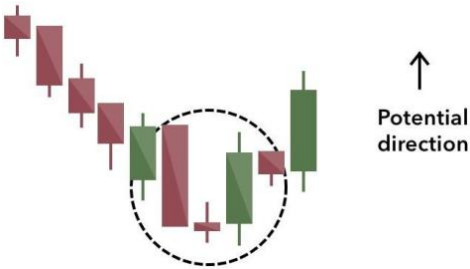


Reversal signal after a down-trend

The piercing line is likewise a 2-stick chart, comprised of a long red candle, trailed by a long green candle.

There is typically a huge gap down between the primary candlestick's closing price, and the green candlestick's opening. It shows a strong buying pressure, as the price is pushed up to or over the mid-price of the previous day.

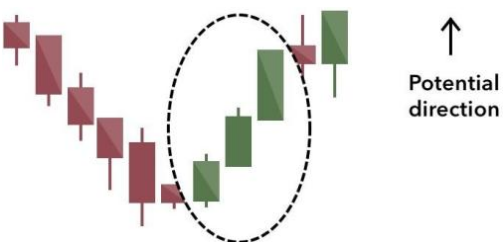
Morning Star



The morning star candlestick chart is viewed as an indication of expectation in a disheartening market downtrend. It is a 3-stick chart: one short-bodied candlestick between a long red and a long green. Customarily, the “star” will have no cover with the more extended bodies, as the market holes both on open and close.

It flags that the selling pressing factor of the principal day is dying down, and a positively trending market is not too far off.

3 White Soldiers



The 3 white soldiers’ pattern happens more than 3 days. It comprises sequential long green (or white) candlestick

with little wicks, which open and close logically higher than the earlier day. It is an extremely strong bullish sign that happens after a downtrend and shows a consistent movement of buying pressure.

6 Bearish Candlestick Patterns

Bearish candlestick patterns as a rule structure after an uptrend, and sign a state of resistance. Substantial negativity about the market price frequently makes traders close their long positions and open a short situation to exploit the falling price.

Hanging Man



The hanging man is what could be compared to a hammer pattern; it has a similar shape, however, frames toward the finish of an uptrend.

It shows that there was a critical auction during the day, however, that buyers had the option to push the price up once more. The huge auction is frequently seen as a sign that the bulls are failing to keep a grip available.

Shooting Star



The shooting star is a similar shape as the inverse hammer, yet is framed in an uptrend; it has a little lower body and a long upper wick.

Typically, the market will gap somewhat higher on opening and rally to an intra-day high prior to shutting at a price simply over the open—like a star falling to the ground.

Bearish Engulfing



A bearish engulfing pattern happens toward the finish of an uptrend. The main candle has a little green body that is immersed by a resulting long red light.

It means a peak or lull of price movement and is an indication of a coming market slump. The lower the

subsequent candlestick goes, the more critical the pattern is probably going to be.

Evening Star



The evening star is a 3-candlestick pattern that is what could be compared to the bullish morning star. It is shaped of a short light sandwiched between a long green candle and an enormous red candlestick.

It shows the reversal of an uptrend and is especially solid when the third candle deletes the increases of the main light.

3 Black Crows



The 3 black crows' candlestick pattern involves 3 successive long red candlesticks with short or non-existent wicks. Every meeting opens at a comparative price to the previous day, yet selling pressures push the price lower and lower with each nearby.

Traders decipher this pattern as the beginning of a bearish downtrend, as the traders have overwhelmed the buyers during 3 progressive trading days.

Dark Cloud Cover



The dark cloud cover candlestick pattern shows a bearish reversal—a dark cover over the earlier day's confidence. It involves 2 candlesticks: a red candle that opens over the past green body and closes beneath its average.

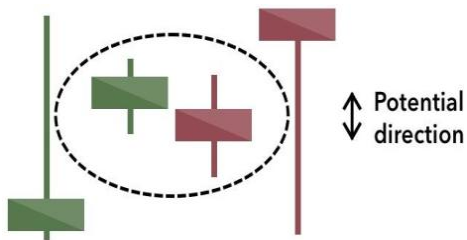
It flags that the bears have assumed control over the meeting, pushing the price strongly lower. On the off chance that the wicks of the candlestick are short, it proposes that the downtrend was incredibly definitive.

4 Continuation Candlestick Patterns

If a candlestick pattern doesn't demonstrate a shift in market bearing, it is the thing that is known as a continuation chart. These can assist traders with

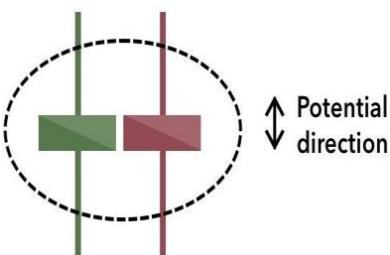
distinguishing a time of rest on the lookout when there is market hesitation or nonpartisan price movement.

Doji



At the point when a market's open and close are nearly at a similar price point, the candle takes after a cross or in addition to sign—traders should pay special mind to a short to the non-existent body, with wicks of changing length. This present doji's pattern passes on a battle among buyers and traders that outcome in no net addition for one or the other side. Alone a doji is an impartial sign, yet it tends to be found in reverse patterns, for pattern, the bullish morning star and bearish evening star.

Spinning Top

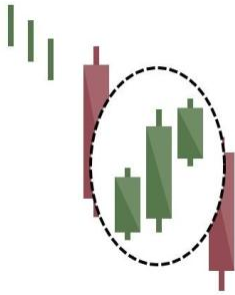


The spinning top candlestick pattern has a short body, focused between wicks of equivalent length. The pattern

demonstrates uncertainty on the lookout, bringing about no significant change in price: the bulls sent the price higher, while the bears pushed it low once more. Spinning tops are frequently deciphered as a time of union, or rest, following a critical uptrend or downtrend.

On its own the spinning top is a generally considerate sign, however, they can be deciphered as an indication of things to come as it implies that the current market pressure is letting completely go.

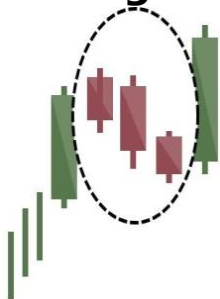
Falling 3 Methods



A 3-method arrangement pattern is used to forecast the continuation of the latest thing, be it bearish or bullish.

The bearish pattern is known as the “falling 3 methods.” It is shaped of a long red body, trailed by 3 little green bodies, and another red body—the green candlestick are completely contained inside the scope of the bearish bodies. It shows traders that the bulls need more strength to alter the course.

Rising 3 Methods



The inverse is valid for the bullish pattern, called the “rising 3 methods” candlestick pattern. It includes 3 short reds sandwiched inside the scope of 2 long greens. The pattern shows traders that, in spite of some selling pressure, purchasers are holding control of the market.

Other Candlestick Patterns

Blue Sky Breakout

Generally, it's a good idea to wait for consolidation before taking out a long position on a security that has been ascending on the price charts. But sometimes it continues to move up for several days or more, causing the traders who are waiting for an entry on the sidelines to feel like they are missing out on the big move. In a relentless bull market, sometimes a trader is left with little choice but to jump into a security without waiting for it to dip a little bit.

A regular breakout is when a stock breaks above a resistance level, but there are still more resistance levels up ahead. A blue sky breakout is when the stock breaks through the final resistance level, leaving no other resistance points up ahead. A resistance level is a zone that a security commonly gets rejected at, indicating that supply has exceeded demand. During a blue sky breakout, you might see a series of green candles consecutively after resistance has been broken. The

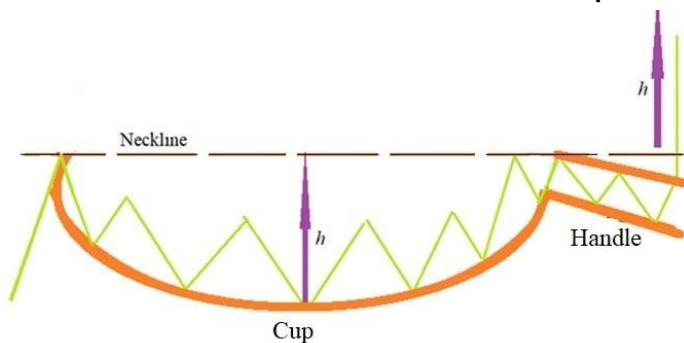
trouble with blue sky breakouts is that by the time the stock takes out the final resistance zone, it is usually already overextended, which could lead to a significant pullback.

If you decide to jump into a blue sky breakout, it's important to watch the trade closely, and not to hold onto it for longer than a few days. One way of knowing if the security will continue to go up is by assessing how much follow-through the stock has after it breaks resistance. If it breaks resistance, but only by a few cents, that's not a very good follow-through.

Cup and Handle

As the name implies, the candlesticks on the chart will resemble a cup and handle. The cup will be on the left side of the handle and it will be in the shape of the letter “U,” while the handle will have a slight downward trend. As long as the bottom has a “U” shape, it is considered bullish, so it presents a buying opportunity. If the bottom has more of a “V” shape, it is best avoided, as the technical analysis indicates.

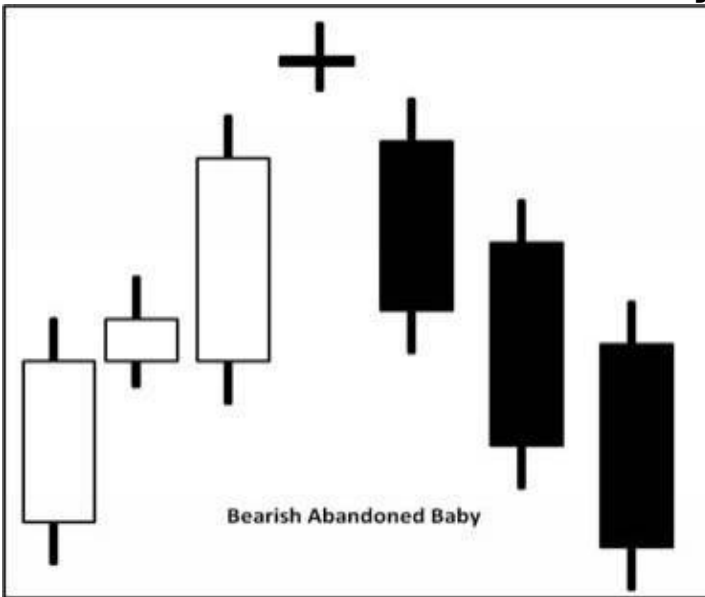
The candlesticks travel in a “U” formation. After making the “U” shaped recovery, they will start trending slightly downward again. Picture a downward slope at the top-right corner of the “U.” The buy signal is presented during the consolidation period of the slight downtrend after the “U” shaped recovery. A realistic profit target can be assessed by measuring the distance between the bottom of the “U” and the top of the “U.”



If the move from the bottom of the cup to the top was 20%, the profit target could be 20%, with a stop-loss placed slightly below the handle formation. One of the

drawbacks to playing a cup and handle pattern is that it can be difficult to tell if the cup is truly presenting a “U” or if it is actually a “V.” Sometimes a sharp, V-looking bottom actually plays out quite well. Another drawback is that the cup sometimes forms without the handle.

The Bearish Abandoned Baby

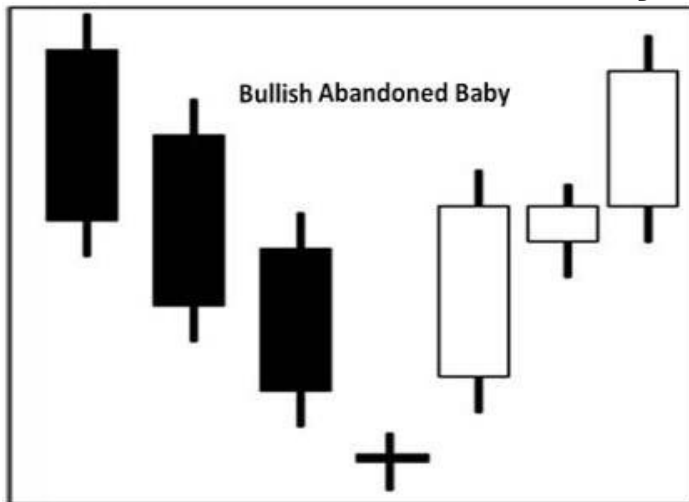


The bearish abandoned baby is a candlestick pattern that usually tells us a reversal in the current uptrend is on its way.

First of all, the previous advance is eclipsed by a doji. That in itself is our first signal, but the confirmation comes the next day with a bearish engulfing candle. When you look at an advance at a stock's price while viewing a chart and see the doji and then see heavy selling the following day that should be enough to get your attention.

In fact, experienced traders who see this pattern form and are holding the stock, usually begin to look back on a longer-term chart to see where support might be found for the stock's price. If it is very far below the current price, they would exit the trade.

The Bullish Abandoned Baby



The bullish abandoned baby is the mirror image of the bearish counterpart.

And once again, the doji is the first sign of change. It appears at the bottom, after a decline, telling us the buyers and sellers are virtually equal. The confirmation of this pattern is the positive candle the very next day.

The TRI Star



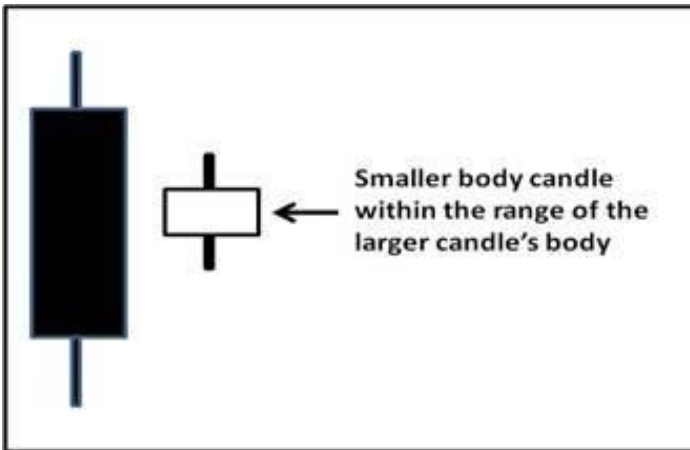
The tri-star is another type of candlestick pattern that signals a reversal in the current trend. This pattern is formed when 3 consecutive doji candlesticks appear after the stock has experienced an advance in price.

The above chart illustrates a bearish tri-star pattern at the top of the uptrend and is used to mark the beginning of a shift in momentum. A seasoned trader would be thinking, "Look out below!"

Keep in mind that even though the tri-star in this chart is clearly formed, many times there may only be 2 stars. Also note that these "stars" are actually doji candles, signifying that neither the buyers nor the sellers have any control since the stock opened and closed at virtually the same price on all 3 days. When you think about neither the buyers nor sellers having control and the doji forms at the end of an uptrend or a down-trend, then many times a change in direction is likely. In this case, 3 dojis were formed. But the important thing is what had previously happened.

The point is a trend in a particular stock or the overall market takes time. We are always looking for recognizable candles, patterns, or formations to appear at the end of an advance or decline. I would prefer to see a stock advance or decline a minimum of 5 days and then see a bottom or top forming. This lets us ignore small candles that appear a day or 2 after a change in trend has happened.

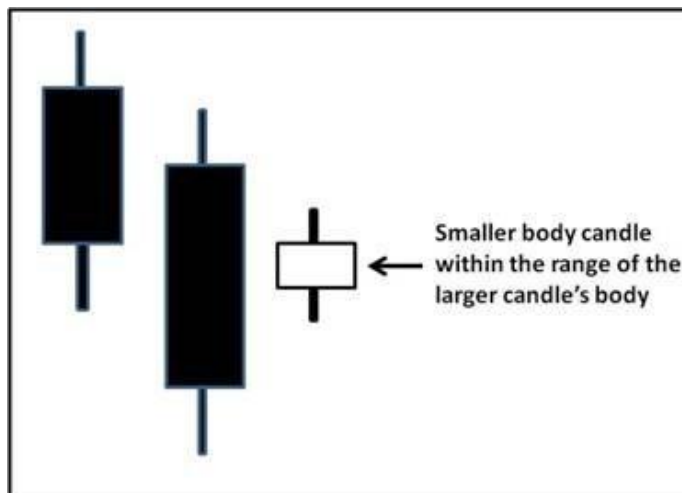
The Bearish Harami



The bearish harami is a pattern that forms at the top after an advance. It is indicated by a large dark candlestick that forms on a negative trading day signaling a change may be in store. Then there's a much smaller candlestick with a body that fits inside the vertical range of the larger candle's body. A pattern like this indicates that the preceding rising trend is ending.

When you think about it, the lower close of the bearish candle is an early warning sign. When this candle forms after an advance, you know the sellers have stepped in. Even before the next candle forms, you should be on high alert if you are holding this stock. Then when the next candle is formed showing the price cannot penetrate the upper area of the previous candle, this sometimes indicates a top has been reached and often reverse in direction will soon take place.

The Bullish Harami

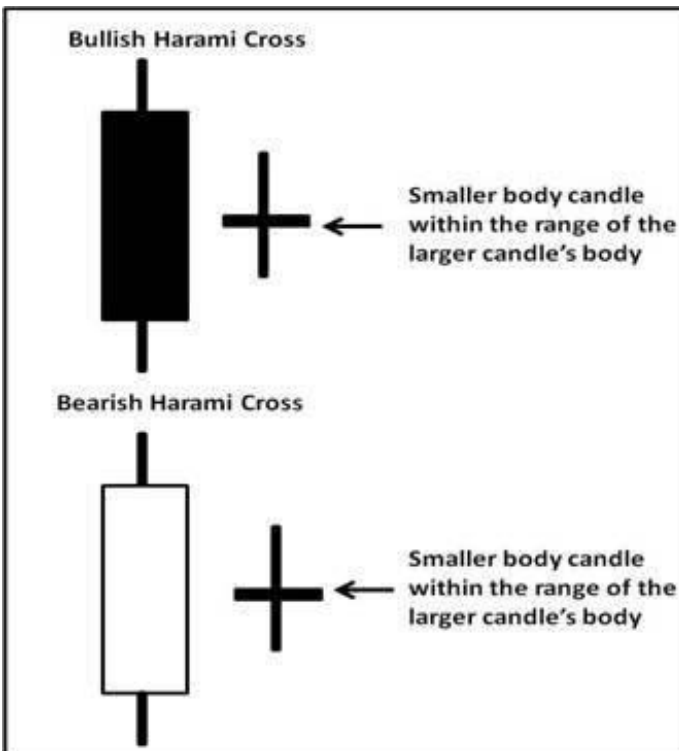


The bullish harami pattern may look very close to the same as the bearish harami, but it forms at the bottom after a decline in the stock's price.

The bullish harami is a candlestick chart pattern in which a large candlestick is followed by a smaller candlestick whose body is located within the vertical range of the larger body candle on the previous day. In terms of candlestick colors, the bullish harami is a downtrend of negative-colored

candlesticks engulfing a small positive (white) candlestick, giving a sign of a reversal of the downward trend.

The Harami Cross



The harami cross is like the previous Harami formations except the small body candle is a doji. This indicates that the previous trend is about to reverse.

Think trader psychology for a moment. With the bearish harami cross, what might have happened in the trading that formed this particular pattern?

Obviously, the large white candle was formed with the market opening and the stock trading higher to the close that day. But on the following day, there are a couple of things we need to mention about the doji:

-
- The stock could not trade above the previous day's range
 - No one had control. It was an even match between the buyers and the sellers.

Now, think about it a little further. If on this day when the doji is formed there are no longer enough buyers to push the price higher, and the sellers continue to sell at this price preventing an advance, the doji tells us that when the buyers and sellers are equal, then further advance may be unlikely.

The bullish harami is just the opposite. There were not enough sellers to push the price lower, meaning, the buyers stepped in after a decline in price and began buying at that level. So, once again, the doji tells the story and indicates a change in direction.

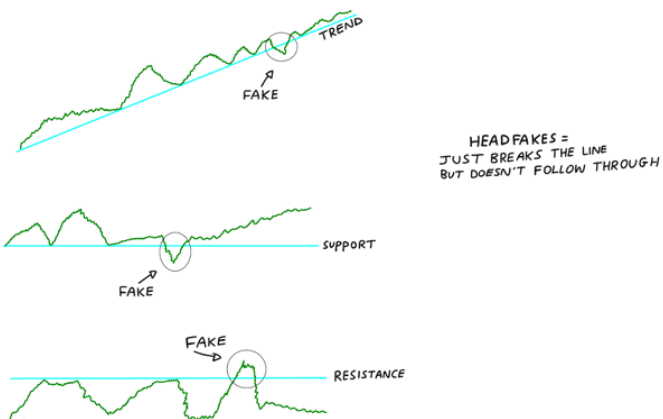
Chapter 8. Avoid the Traps

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Trading chart patterns always sound so easy to do. Websites show you successful and profitable trades, and you look at the pattern and say, "oh yes, of course, anybody could have spotted that," and it looks so easy.

It's not. First of all, you have to kiss a lot of frogs—that is, for every chart that shows you a meaningful pattern, you're going to see an awful lot of charts where there's no clear trend at all. Secondly, some patterns can be deceptive and set traps for the unwary trader. For instance, "headfakes" often happen when you were expecting a proper breakout. And thirdly... some traders make life awfully difficult for themselves, whether through being too emotional, not setting stop-losses, not considering risk, or not knowing what some of the bad patterns look like.

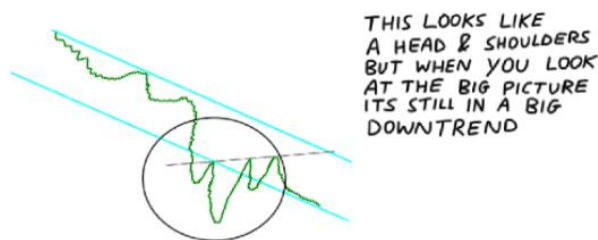
Fakeouts and Fake Head-and-Shoulders



Sometimes the set-up looks great... but then the expected price movement fails to emerge. Prices move the “wrong” way for your trade. These are like a "headfake." But there are ways to check them out and avoid a few of the fakes.

You may fall into the trap of looking at a head and shoulders formation without realizing that it's actually just a blip in a bigger trend. Always check your chart for a longer time period before acting on some trade.

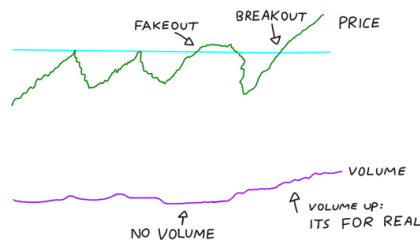
By the way, remember to check the pattern against the big picture. In the chart below, you think you see a head and shoulders formation, but actually, it's happening within a major trend and the trendline, not the neckline, is what matters. Always remember to look at several different time periods—I always look at 1 month, 6 months, 1 year, and 5 years, which may be overdoing it—so you don't get caught by a pattern that doesn't work.



Even if the price here had broken through the neckline, the top line of the downtrend channel would probably put up resistance, and that would limit your likely profits.

Or you may see the price come down to the neckline of the right shoulder, but not actually break through it. It might just dip below it in intra-day trading but still close above it. This isn't a proper breakout—wait for the price to close below the neckline before you buy.

In many head and shoulders patterns, there's a false breakout with a retracement before the real one. Sometimes, market practitioners are just trying to ensure traders with tight stop-losses are "stopped out" before the price really moves. So, don't put your stop too tight, and be ready even if it's activated to jump back into the next breakout.



You also get fakeouts—for example, the price breaks the trendline to the upside, but then it falls back again, instead of giving you the expected breakout. You'll probably fall into that trap a few times, but some confirmations can help you avoid it:

- If there's a low volume of trading, it's probably a fakeout; breakouts have high volume.
- If the price is headed very slowly towards the trendline, it's probably a fakeout; breakouts have real momentum and tend to start with a really big move.
- A fakeout from a double top or double bottom is one that doesn't lead to the expected reversal—instead, you get a continuation. If you recognize it, you can simply reverse your trade—if you expected a double top to lead to a fall, and the price starts heading up, then stop the short and go long.
- Try placing your stops just short of the “expected” price or just a little more. Double bottoms, for

instance, are well-known patterns, and lots of traders will have stop-losses at exactly the same price, often a round number. If you stay away from that level, you may not get faked out if the market-makers try to "shake the tree."

No Trend at All

Almost every good chart pattern needs a good strong trend established for it to work. It is really, really difficult to make money trading when there's no trend. And the market can be trendless for

60-70% of the time. If you don't trade for nearly 3-quarters of the year, how on earth can you make money? Mind you, if you don't see any good trades in a sideways market, don't force the issue. It's always better to have cash sitting in your account than to waste it trading for the sake of trading. Taking a risk when you haven't identified a return is one of the dumbest things you can do.

Mean-reversion trades are probably your best bet. The concept of mean reversion is that statistical probabilities group towards the mean (average) so that if a price goes to an extreme high, it will probably fall back; if it goes to an extreme low, it will probably rise again. Even sideways markets have a range, though they don't have a trend, so identify that range and you've got a trading strategy.

But to carry out these trades, you need to get 4 things right:

- Detect oversold/overbought stocks using momentum and volume indicators, not just price charts.
- Buy stocks when they are trading on the low side of the range. It may be profitable to wait for a slight bounce so you know you're not going to get stuck in a downwards breakout that could cost you money. Your target price is not the other side of the range, but the middle (so your profit is half the width of the range).

- Be careful with your stop-losses. If there's a breakout, you do not want to get hit.
- If there is a breakout, it may be worth joining it. Again, be careful; set a tight stop-loss.

You will not make big money in sideways markets. You can make a little. If markets are range-bound for a long time then you may need to consider trading them, but to be honest, the risk-reward ratio is not that good, so I prefer to sit them out. Or you might look at another market to trade— foreign exchange, commodity ETFs, or futures; but to do that, you really should have already at least paper-traded these markets, or you could be jumping out of the frying pan into the fire.

Adjust Your Moving Averages

Most chart packages have already decided which moving averages to display. These are often, for instance, the 9 and 18-day averages, or 9 and 26-day, or 50 and 200.

But these might not be the best averages for you. Don't fall into the trap of letting a charting site decide which moving averages you should use.

For instance, if you've decided to become a day trader, you'll want to get something like 5-8-13 bar averages. You can get price bars for every hour, every 5 minutes, or every minute even, so you might have a 5-8-13 minute average instead of 5-8-13 days. Watch out though, because though in a good trend, they'll give you great signals; in choppy trading, they can be all over the place, and you're best declaring time out, going flat (closing all your positions), and going to get a coffee.

If you trade longer term, you'll want to look at longer-term averages such as the 26 and 50-day SMAs or EMAs. 20/21 are good for swing traders together with the 50-day; the 200 and 250-period MAs go well as the slower average.

Remember, the EMA moves faster than the SMA, so it will flag up trades more quickly—but you pay a price for this because it will give you more false signals than the SMA. If you're happy making a lot of trades and closing the bad ones quickly, use the EMA, as it will get you into

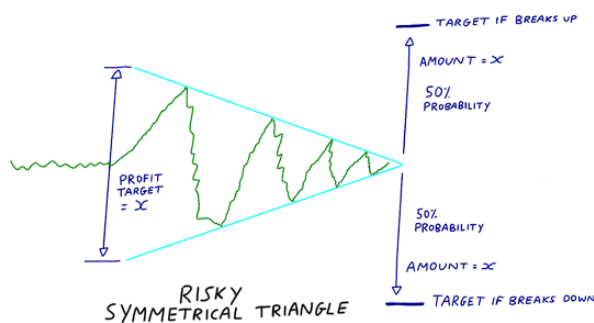
a price swing more quickly; but if you want to trade longer-term, and keep your positions longer, then SMAs will give you winning trades that are slightly less profitable, but fewer stopped-out trades and fewer trades overall.

One of the reasons MAs work is that nearly everyone uses them. So, while you might think it's fun to create a 34-day moving average, it might not give you any useful, actionable information. You can try it, backtest it on a few charts and see. But I doubt you'll actually find that it's a secret weapon. I've tried a few and they've never worked out.

And lastly, moving averages just don't work in trendless markets. When the market is ranging, don't try to use the MAs for trading ideas—they're going to be all over the place and will only get you into trouble. Wait till you can see a clear trend again.

Risky Symmetrical Triangle

We've looked at ascending and descending triangles, which can give you a great trading signal. But sometimes the trendlines form a symmetrical triangle. The highs are getting lower, and the lows are getting higher, and when the 2 lines meet, something has got to happen. The trouble with this formation is that it's super risky. The chances are 50% it'll be up, and 50% it'll be down, and at a guess about 90% that it'll be fast and furious.



As I've stressed repeatedly, the trend is your friend, and trading a market that's not got a clear trend is tricky. And by definition, with one trendline going up and one coming down, with the symmetrical triangle, you have a

trendless market—unless there's a really good strong moving average line, for instance, in which case you have a 50-60% chance that the breakout will be in the same direction. But there's also a good chance that there will be a fakeout first (usually with low volume while the real breakout will see an increase in trading volume).

So if you're risking on one of these triangles, it may be better to wait till the breakout and new trend are clear—and keep your stop-losses tight or the price could run away from you in the wrong

direction. In fact, prices quite often gap-up (or down) from these formations, so even your stop-loss may not help you.

Your profit target can be measured by taking the depth of the triangle when it began to form and adding that to the breakout point. Your stop-loss should be at the last point at which the price touched the bottom line of the triangle. Since this is a 50-60% probable pattern, you're going to want a better than 2:1 risk/reward ratio for it to be potentially profitable. I wouldn't take it on much below 4:1, personally.

But you can ride the trend if you look at the moving average. As long as the price stays above the 20-50-day MA, you can keep your trade moving and bring your stop-loss up to date with the moving average every day. That way, you'll be stopped out automatically if the trend changes. A trailing stop like this is a great way to run a longer-term position.

Super Rocket Stock

One of the big dreams of the stock market is the one stock that will make you your fortune. "If I'd put every penny in my IRA into this stock... if I'd mortgaged my house and bought this stock... If I'd maxed out my credit card to buy this stock..."

Point one: Do not trade anything other than risk capital. That is money that you know you could afford to lose. If

you lost your house and your pension and owed the credit card company \$50,000, you would be in dire straits. Don't go there.

But secondly, this dream is exactly that—a dream. Shares do not go up and up and up. They go all around the houses.



Let's look at Cisco—a “rocket” of the tech boom. If you bought and held Cisco at \$1.92 in 1994, you would have made a load of money. If you'd bought it at \$15 towards the end of 1998, you would have seen it soar to over \$80—and then fall back to below the price you paid for it by the end of 2002. Now, it would be worth \$50. (This chart is from Bigcharts. Their data goes way, way back. Not all chart sites have such good long-term data.)

Plenty of gurus are keen to sell you their “rocket stocks.” They'll use a combination of different approaches—analyst upgrades, earnings surprises, charting, trade volume. And they perform okay—for a while. But the problem with analyst upgrades is that analysts usually base their estimates on what the company tells them, and few analysts want to get out of step with a rising market—they fear if they call the top and the market keeps going up, they'll be fired. And the problem with “rocket stocks” is that there are many other people who have got in at the same time, and the same price, as you. If things go wrong, they'll chicken out.

These stocks are often really speculative, like GameStop, for instance. I'd call Tesla a super-rocket—it's been driven by having a great story and a charismatic CEO, but it hardly makes any money, and competition from companies like Toyota, Volkswagen, and Renault is heating up. (Incidentally, Volkswagen is up 62% from its lows. Good money for those who caught it.)

That means there's nothing to keep the share price from falling off a cliff. I know that we're talking about technical analysis and not fundamentals, but with stocks like this, I worry that the market is full of people who've heard the story but don't really understand the numbers. That pushes the stock up, and up, and up—and if you remember the parabolic rise? That's the trap.



Long Candles

But sometimes, a super-long candlestick can be a trap. It looks like a bullish signal—and for a little while, it is. But while the share price may test resistance above this long candle, it's usually a bull trap and the share price will, after a while, come back to earth. And it can hit the ground hard.

Why does this big candle happen? New buyers are coming into the stock thinking that it's making a breakout. Maybe some big players are pushing the price up. What's important is that this long candle doesn't sit

nicely among the other candlesticks—it's isolated. There may even be 2 big candlesticks.

Maybe you missed that signal, and you're sitting in the trading range on top. You'll often get another chance because a huge candlestick with a big upside shadow or wick will fake a breakout from the trading range. Novice traders will look at a big white or green candle and say, "Yay! Breakout!" Experienced traders will look at the big shadow on the upside, and they know that it means the market was trying to push prices higher and higher, but it wasn't working.

However, you should always check signals in a longer or shorter timeframe. For instance, a green/white weekly candle with a huge upper shadow looks as if the market tested the highs and couldn't sustain them. If you look at the daily candles, though, you may find that you have a pattern that is trading within the expected channel—up to the topside trendline and then just a small correction. In that case, don't get suckered—if you are long on the stock, it's still on course.

Lack of Discipline

The worst trap that most traders face is a lack of discipline. That might mean not getting up to catch the market open, not setting stop-losses, or not taking a trade where all the signals look good because you don't like the stock. Once you've decided on a trading strategy and on which signals are the ones you're going to trade, stick to your strategy and system. Chopping and changing lose trader's money...

It's about trading psychology—the psychology of other traders, but most importantly, your own.

Chapter 9. Trading Psychology

Trading With Emotions

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t is common for traders to have their emotions and feelings jumbled up when day trading, from the highs and the lows they experience from the market. This is a far outcry from the confident self that a trader usually poses before the markets open, bubbling up with excitement over the money and profits that they intend to make. Emotions in trading can mess up and impair your judgment and your ability to make wise decisions. Day trading is not to be carried out without emotions, but rather as a trader. You should know how to work your way around them, making them work for your good. A clear level headed and stable mind should be kept at all times, whether your profits are on the rise, or whether you are on a losing streak. This does not mean that as a trader, you are supposed to disconnect from your emotions. A person cannot avoid emotions, but in

the face of real market scenarios, you have to learn how to work on and around them. The personality type of a trader plays a huge role in determining which kind of a trader they are. The cautious traders are mostly controlled by fear when opening up trades, while the risky type is in the greed-motivated bandwagon. Fear and greed are such huge motivators that they go a long way in the layout of losses and profits.

Greed

A trader may be fueled to earn more money by checking their balances in their accounts and seeing it be as of a low level. While this may be a motivator to work hard, some traders take it too far, wanting to earn a lot of money right there and then. They make mistakes while trading that has reverse effects than the intended ones. Such mistakes include an overtrade, taking unnecessary risks, among others.

Taking Unnecessary Risks

Greed for more money will seek to convince the trader to take risks that are not worth it to achieve a certain financial threshold in the trading account. These will most likely end up in losses. The risky traders may take risks such as high leverage, that they hope will work in their favor, but at the same time may have them making huge losses.

Making an Overtrade

Due to the urge to make more and more money, a trader may extend trading over long periods of time. Commonly these efforts are futile because the overtrading through market highs and lows put a trader in a position where their accounts can be wiped out due to greed. Disregarding the fact, time to trade and dive into opening trades without having done an analysis will most likely result in a loss.

Improper Profit and Loss Comprehension

Wanting to earn a lot of money within a short period of time, a trader will not close a losing trade, maintaining the losses, and on the other hand, overriding on profit-making trade until a reverse in the market happens, canceling out all the gains made. It is advisable to

maximize and specialize in a successful trade and close a losing trade early enough, avoiding major losses.

Fear

Fear can work in both directions, as a limit to an overtrade, or also as a limit to making profits. A trader may close a trade so as to avert a loss, the action motivated by fear. A trader may also close a trade too early, even when on a winning streak in making gains, in fear that the market will reverse and that there will be losses. In both scenarios, fear is the motivator, working in avoiding failure a success at the same time.

The Fear to Fail

The fear to fail in trading may inhibit a trader from opening up trades, and just watch as the market changes and goes in cycles when doing nothing. The fear of failing in trading is an inhibitor to success. It prevents a trader from executing what could have been a successful trade.

The Fear to Succeed

This type of fear in trading psychology will make a trader lose out their profits to the market when there was an opportunity to do otherwise. It works in a self-harming way in market scenarios. Such traders in this category fear to have too much profit and allow losses to run, all the while aware of their activities and the losses they are going to make.

Bias in Trading

There are several market biases that a trader may tend to make that may be as a result of the emotions play, which traders are advised against. In the psychology of trading, these biases may influence a trader to make unwise and uncalculated trading decisions that may prove to be loss-making ones. Even when the trading biases are in focus, as a trader, you have to be aware of the emotions in you and come up with ways to keep

them under control and maintain a cool head in your trading window. They include the bias of overconfidence, confirmation, anchoring, and loss.

Bias in Overconfidence

It is a common occurrence with traders, especially new traders, that when you make a trade with huge profits, you get in euphoria in the state of winning. You want to go on opening up trades, with the belief that your analysis cannot go wrong, boiling down to the profits and gains you've made. This should not be the case. You as a trader cannot be too overexcited and overconfident in the analysis skills that you believe you cannot make a loss. The market is a volatile one, and therefore,

the cards can change at any given time, and when they do, the overexcited and overconfident trader now turns into a disappointed one. Get your analysis of the market right before opening up any trade, regardless of the previous trades, whether they were a loss or gain.

Bias in Confirming Trades

In trading psychology, the bias in confirmation of a trade you have already made, justifying it, is one of the factors that waste a lot of time and money for traders. This type of bias is mostly associated with professional traders. After making a trade, they go back in evaluating and analyzing the trade they just made, trying to prove that it was the correct one, whether they sailed according to the market. They waste a lot of time digging for information that they are already aware of. They could also be proving that the mistake they did in opening a wrong trade and making a wrong move was a correct one. Nevertheless, the bias in confirmation occurs when a trade they made turns out to be correct, and this strengthens their determination in their researching skills, further pushing them in wasting time in proving to themselves already known facts. They could also lose money in the process, and it is, thus, advisable against this form of bias in trading.

Bias in Anchoring on Obsolete Strategies

This type of bias in the psychology of trading applies to the traders that rely so much on outdated information and obsolete strategies that do more harm than good to their trading success. Anchoring on the correct but irrelevant information when trading might make the trader susceptible to making losses, a blow to the traders who are always lazy to dig up new information on the market. Keeping up with the current events and factors that may have an impact on the market is one of the key aspects of having a successful trading career. Lazy traders will tire of keeping tabs with the ongoing economic and even political situations whose influence is exerted on the foreign exchange market. An example of this is that some traders will have a losing trade, but they hope that the markets will reverse their assumptions based on obsolete information and

strategies. Carry out extensive research, mindful not to be too time-consuming, to ensure you make trades in accordance with the right data.

Bias in Avoiding Losses

Trading with the motive to avert losses usually boils down to the factor of fear. There are some traders whose trading patterns and their trading windows are controlled by fear of making losses. Having gains and making profits is not a motivation to them when fear hinders them from opening trades that could have otherwise been profitable. They also close pas trade too early, even when making profits in a bid to avert the losses, their imaginable losses. After carrying out a proper and detailed analysis on the market, go for making profits without being deterred with the bias of avoiding to make a loss, for that just holds many traders. Come up with a plan for your day trading to deal with doubts about the trades you are to make.

Psychology Affecting Traders' Habits

Psychological aspects affect habits in trading, the mistakes, and the winning strategies that a trader comes up with. Explained below are the negative habits that

many traders make, with the influence of psychology on their habits.

Trading Without a Strategy

With no trading strategy and plan, a trader will face challenges with no place to refer to the anticipated end result. A proper strategy should be drawn by a trader to be a referencing point when facing a problem in trading in the market. It should be a clearly constructed plan, detailing what to do in certain situations and which type of trading patterns to employ in different case scenarios. Trading without a strategy is akin to trading to lose your money.

Lack of Money Management Plans

Money management plans are one of the main aspects of trading, and without solid strategies in this, it is difficult to make progress in making gains in the trades opened. As a trader, you have to abide by certain principles that will guide you in how to spend your money in the account in opening up trades and ensuring that profits ensue from that. Without money management plans, a trader would be trading blindly with no end goal in mind, risking the money in non-profitable trades.

Wanting to Be Always Right

Some traders always go against the market, placing their desire of what manner they would like the market to behave in. They do not follow the sign that the market points to, but rather they follow their own philosophy, not doing proper analysis and always wanting to be right. Losses ensue from such psychological habits. When the trading window closes, the market will always overrule the traders. Thus, a trader's want to be always right against the market is overruled.

Looking at the Analysis

It's important to understand how to perform a proper technical analysis not just to determine the value of a

certain option but also to make sure you don't scare yourself away with any certain number. You might see a dip in a chart, or a price projection lower than you hoped, immediately becoming fearful and avoiding a certain option. Remember not to let yourself get too afraid of all the things you might come across on any given trading chart. You might see scary projections that show a particular stock crashing, or maybe you see that it's projected to decrease by half.

Make sure before you trust a certain trading chart that you understand how it was developed. Someone that wasn't sure what they were doing might have created the display, or there's a chance that it was even dramatized as a method of convincing others not to invest. Always check sources,

and if something is particularly concerning or confusing, don't be afraid to run your own analysis as well.

Hearing Rumors

If you are someone that hangs around with other traders, maybe even going to the New York Stock Exchange daily, there's a good chance you are talking stocks with others. Make sure that any "tips" or "predictions" you hear are all taken with a grain of salt. Tricking others into believing a certain thing is true about different stocks and options can sometimes dapple into an area of legal morality, but it's important to make still sure you don't get caught up with some facts or rumors that have been twisted.

You should only base your purchases on solid facts, never just something you heard from your friend's boyfriend's sister's ex-broker. While they might have the legitimate inside scoop, they could also be completely misunderstanding something that they heard. Before you go fearfully selling all your investments from the whisper of a stranger, make sure you do your research and make an educated guess.

Accepting Change

As animals, we humans are constantly looking for a constant. We appreciate the steadiness that comes

along with some aspects of life because it's insurance that things will remain the same. Sometimes, we might avoid doing something we know is right just because we are too afraid to get out of our comfort zone. Make sure that you never allow your fear of change to hold you back.

Sometimes, you might just have to sell an old stock that has been gradually plummeting. Maybe you have to accept that an option is no longer worth anything, even though it's been your constant for years. Ask yourself if you are afraid of losing money or just dealing with the fear.

Know When to Stop

For you to know when to stop can be the most challenging part of life. It's so hard to say no to another episode when your streaming service starts playing the next one. How are we supposed to say no to another chip when there are so many in the bag? Sometimes, if you see your price rising, you might just want to stay in it as long as you can. In reality, you have to make sure that you know when it's time just to pull out and say no.

If you wait too long, you could end up losing twice as much money as you were expecting to make. This is when the gambling part comes in, and things can get tricky. Make sure you are well-versed in your limits and that you are not putting yourself in a dangerous position if you don't trust your own self-control.

Accept Responsibility

Sometimes, we don't want to have to admit that we're wrong, so we'll end up putting ourselves in a bad position just to try to prove to someone, even just ourselves, that we were right. For example, maybe you told everyone about this great investment you were going to make, sharing tips and secrets with other trader friends about a price you were expecting to rise.

Then, maybe that price never rises, and you are left with just the same amount that you originally invested. You were wrong, but you are not ready to give up yet. Then,

the price starts rapidly dropping, but you are still not ready to admit you are wrong, so you don't sell even though you start losing money. You have to know when just to accept responsibility and admit that you might have been wrong about a certain decision.

Discipline

Having a good knowledge and understanding of different stocks and options is important, but discipline might be the most crucial quality for a trader to have. Not only do you have to avoid fear and greed, but you have to make sure to stay disciplined in every other area.

On one level, this means keeping up with stocks and staying organized. You don't want just to check things every few days. Even if you plan on implementing a longer strategy for your returns, you should still keep up with what's happening in the market daily to make sure that nothing is overlooked.

On a different level, you have to stay disciplined with your strategy. Decide where personal rules might bend and how willing you are to go outside your comfort zone. While you have to plan for risk management, you should also plan that things might go well. If the price moves higher than you expected, are you going to hold out, or are you going to stay strict with your strategy?

Stick to Your Plan

If you don't stick to the right plan, you might end up derailing the entire thing. You can remember this element in other areas of your life. You can be a little loose with the plan, but if you go off track too much, what's the point of having it in the first place? If you are too rigid, you could potentially lose out on some great

opportunities, but too loose can make everything fall apart.

Prepare for Risk Management

Aside from just knowing when to pull out to avoid being greedy, you also need to make sure that you are doing it so you don't end up losing money. Have plans in place for risk management, and make sure that you stick to these to ensure you won't be losing money in the end.

Determine What Works Best

The most important aspect of a trading mindset is remembering that everyone is different. What works best for you could be someone else's downfall and vice versa. Practice different methods, and if something works for you, don't be afraid to stick to that. Allow variety into your strategies, but be knowledgeable and strict with what you cut out and what you let in. Identify your strengths and weaknesses so that you can continually grow your strategies and always determine how you can improve and how you can cut out unnecessary losses.

Exercise Patience

In the world of investing, patience is the greatest virtue you can exercise. Most folks who venture into the world of investing in financial markets are hopeful they can make a good amount of money quickly. However, like anything in life, it takes time before you can become good at it.

This is why professional investors always preach patience.

If you go to your local bank right now and talk to an investment advisor, they will tell you to be patient, especially if it is going through a rough patch. They will tell you that you can make good returns, but you need to stay in the market long enough to see the results. They

may even show you calculations of how your money compounds over time, thus giving you fabulous returns after 10- 20 years.

Now, you surely don't have 20 years to make money at the moment. Well, it might be a good secondary investment, but certainly not something that you'd be betting on. Nevertheless, being patient is essential to making money in any type of investment.

You are only risking a small portion of your overall investment. This means that you can start small, but due to the power of compounding, you can make a serious amount of money.

This strategy has been successful for plenty of investors. But it takes time and study before you can make this strategy work. You need to keep in mind that rolling over money like this requires you

to go on a winning streak. Therefore, you must have the right tools and information before making it big.

Why Trading Psychology Is Important

Most people fail in day trading because they start at the wrong end. They start by learning trading skills first, then move on to money and risk management techniques, and the last stop is to learn, superficially, about trading psychology.

In fact, the right sequence of learning day trading should be learning the trading psychology first, then money and risk management techniques, and the last part should constitute learning the trading skills.

It is very easy to learn technical analysis and how to use technical indicators. But it is very difficult to control one's emotions like fear and greed while trading or astutely manage money while day trading.

If you look at people in different fields, you will find the mindset is the main difference between those who reach the pinnacle of their chosen career and those who remain mediocre. Be it business, science, technology, sports, or any other creative pursuit; people who train their minds for success are the ones who win the race.

In intra-day trading also, hundreds and thousands of day traders use the same methods of technical analysis;

however, only a few of them succeed in making profitable trades, and others go home with losses. It is the trading psychology that makes the difference between successful traders and those who failed.

Every trader, who tries to learn day trading, knows that there are certain rules to be followed, and still, the majority of them fail to do so; therefore, if you want to succeed in day trading, you must pay attention to how you react to markets. Stock trading is nothing but watching the price rise and fall and trading off with the trend. But still, traders fail to follow this simple method of trading.

Day trading happens 90% in the mind of a day trader, and only 10% in what happens in markets. A day trader takes decisions based on what they think is going to happen in stock markets and not on what is happening. This is the biggest mistake day traders make, and the reason is their emotions.

To overcome this psychological hurdle, day traders must learn how to manage their trades without emotions. They can do so only with the help of technology and self-discipline. If they do not have self-control or do not follow a disciplined trading plan, they cannot make profits in stock markets.

At a fundamental level, traders' emotions usually drive markets across the globe.

There are essentially 2 sentiments and states of mind that determine failure or success in stock trading: greed and fear. A trader's emotional nature largely establishes if they are going to be successful in stock trading. In establishing trading success, any trader's trading psychology can be as crucial as some other qualities, like knowledge, skill, and experience. Self-discipline, as well as risk-taking, are 2 extremely crucial parts of trading psychology. For the success of one's trading plan, following these factors is very important. Although fear and greed are definitely the 2 common emotions related to trading psychology, some other emotions also generate trading habits, such as hope and regret.

To have an understanding of trading psychology, just think about a few examples of the emotions connected with it.

Greed is usually an extreme wish for riches. Greed frequently motivates traders to remain in a profitable trade more than is sensible, in an attempt to get more profits from that trade, or even undertake big risky positions. Greed can be most evident in the last stage of bull markets, where speculation operates on a wider level, and traders and investors become careless.

On the other hand, fear makes traders exit positions too early or even stay away from tasking risk due to anxiety about big losses. Fear can be prevalent in the times of bear markets, which, as a powerful emotion, can induce traders and investors to do something irrational in their rush to close

the trade. Fear usually turns into panic, which usually provokes markets to fall at a considerably faster pace compared to their upward trend.

Regret is another emotion that could cause a trader to enter a trade after originally missing it, as the stock changes too quickly. It is against trading wisdom and quite often leads to the trader entering way too late in the trade.

Successful traders follow some common psychological rules that add to their success. These include:

- They do not overtrade. They know their limits.
- They preserve their trading capital through risk management to gain trading success.
- They maintain their trading discipline at all times.
- They know the difference between not going against the trend and following the herd.

Psychologically Approach Toward Success

It may not seem to be a significant factor on the surface. However, psychology plays a huge role in the way investors conduct their trades. Psychology is arguable the most important aspect when investing. The fact of the matter is that for all of the analysis and research that you can conduct, you may find yourself falling victim to some of the most common issues that occur to traders. When an investor can control their emotional responses

to the way trades are conducted, there is a greater possibility of success.

The most important factor you can put into practice when it comes to devising your investment approach is realistic expectations. This means that you are aware of the fact that investing takes time and effort. Of course, you're not expecting to take years before making a profit. However, you should keep in mind that starting small can ultimately pay off in droves later on.

When you start small, you can build momentum. When you build momentum, there is a snowball effect that makes you make more money. Sure, it's tempting to think that you could make 1 year's

salary when in a single trade. Still, then again, you will eventually reach that level after gaining the experience that top traders have gained.

It's like pilots; as they accumulate flight hours, they can fly without instrumentation, relying on their experience and better judgment. Now, that doesn't mean that the pilot no longer needs the plane's instrumentation. It just means that they can use their judgment, especially when unexpected circumstances arise.

Also, having realistic expectations is vital to ensure that greed doesn't get the better of you. You see, greed is a very powerful force, particularly when you are good at investing. There is a temptation to take greater and greater risks. Eventually, though, you make one mistake that can derail a long time's worth of success. So, having realistic expectations is a great way of curbing the temptation to take unnecessary risks.

Chapter 10. 10 Top Tips for Each Aspect of Trading

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ou have to understand that the stock market is a very volatile place, and anything can happen within a matter of a few seconds. You have to be prepared for anything that it throws at you. In order to prepare for it, you have to make use of risk capital. Risk capital

refers to money that you are willing to risk. You have to convince yourself that even if you lose the money that you have invested, then it will not be a big deal for you.

For that, you have to make use of your own money and not borrow from anyone, as you will start feeling guilty about investing it. Decide on a set number and invest it.

1. Research

You have to conduct thorough research on the market before investing in it. Don't think you will learn as you go. That is only possible if you at least know the basics.

You have to remain interested in gathering information that is crucial for your investments, and it will only come about if you put in some hard work towards it. Nobody is asking you to stay up and go through thick textbooks. All you have to do is go through books and websites and gather enough information to help you get started on the right foot.

2. Stop-Loss/Take Loss

You have to understand the importance of a stop-loss mechanism. A stop-loss technique is used to safeguard investment. Now say, for example, you invest \$100 and buy shares priced at \$5 each. You have to place a stop-loss at around \$4 in order to stop it from going down any further. Now you will wonder as to why you have to place the stop-loss and undergo one, well, by doing so, you will actually be saving your money to a large extent.

Take a Loss

It is fine to take a loss from time to time. Don't think of it as a big hurdle. You will have the chance to convert the loss into a profit. You have to remain confident and invested.

You can take a loss on a bad investment that was anyway not going your way. You can also take a loss on an investment that you think is a long hold and will not work for you in the short term. Taking a few losses is the only way in which you can learn to trade well in the market.

These form the different "do" of the stock market that will help you with your intra-day trades. Below are the "don'ts" of day trading.

3. No Planning

Do not make the mistake of going about investing in the market without a plan in tow. You have to plan out the different things that you will do in the market and go about it the right way. This plan should include how much you will invest in the market, where you will invest, how you will go about it, etc. No planning will translate to getting lost in the stock market, which is not a good sign for any investor.

4. Over-Rely on a Broker

You must never over-rely on a broker. You have to make your own decisions and know what to do and when.

The broker will not know whether an investment is good for you. They will only be bothered about their profits. If they are suggesting something, then you should do your own research before investing in the stock. The same extends to emails that you might receive through certain sources. These emails are spam and meant to dupe you. So, don't make the mistake of trusting everything that you read.

5. Message Boards

You have to not care about message boards. These will be available on the Internet and are mostly meant to help people gather information. But there will be pumpers and bashers present there. Pumpers will force people to buy a stock just to increase its value, and bashers will force people to sell all their stocks just because they want the value to go down. Both these types are risky, as they will abandon the investors just as soon as their motive is fulfilled. So, you have to be quite careful with it.

6. Calculate Wrong

Some people make the mistake of calculating wrong. They will not be adept at math and will end up with wrong figures. This is a potential danger to all those looking to increase their wealth potential.

If you are not good at calculating, then download an app that will do it for you or carry a calculator around to do the correct calculations. The reason is to make the right calculations and increase your wealth potential.

7. Copy Strategies

Do not make the mistake of copying someone else's strategies. You have to come up with something that is your own and not borrowed from someone else. If you end up borrowing, then you will not be able to attain the desired results. You have to sit with your broker and come up with a custom strategy that you can employ and win big.

These form the different "don't" of the stock market that will help you keep troubles at bay.

8. The Main Tools Used in Trading

Just like starting any other business or profession, you need a few important tools to begin day trading. Basically, you need a broker and a platform to execute your orders. These are the tools that you will certainly need to function as a day trader.

As explained, you also need a stock scanner to help you find a watch list and look for potential setups in real-time. On top of a stock scanner, it is ideal to be part of a trading community.

For you to carry out day trading successfully, there are several tools that you need. Some of these tools are freely available, while others must be purchased. Modern trading is not like the traditional version. This means that you need to get online to access day trading opportunities.

Therefore, the number one tool you need is a laptop or computer with an internet connection. The computer you use must have sufficient memory for it to process your requests fast enough. If your computer keeps crashing or stalling all the time, you will miss out on some lucrative opportunities. There are trading platforms that need a lot of memory to work, and you must always take this into consideration.

Your internet connection must also be fast enough. This will ensure that your trading platform loads in real-time.

Ensure that you get an internet speed that processes data instantaneously to avoid experiencing any data lag. Due to some outages that occur with most internet providers, you may also need to invest in a backup internet device such as a smartphone hotspot or modem.

9. Market Data and Trading Platform

You can be successful in your trades if you know how to execute your trades in a jiffy. You must be able to move in and out of the trades easily.

It can be a challenge to perform trades fast enough if your broker doesn't use a platform or software with hotkeys.

You need to make fast decisions so you can make extra dollars when the stock suddenly spikes. If the stock rises, you need to be able to place money in your account and make money from it fast. You certainly don't want to be bumbling with your orders. You need fast executions, which is why you really need to use a good broker as well as a platform for quick order execution.

10. Stocks Scanner and Watch List

One of the common concerns among new traders is that they do not know the stocks to trade. Every day, thousands of stocks move in the market. However, looking for a setup that is an excellent fit for your risk tolerance and consistent with your day trading strategy can be difficult.

You need to use a scanner to browse the market and look for good trades. The most popular stock scanners for day traders are the following:

- Stock Rover
- Cartmill
- Finviz
- Stock Fetcher

Community of Traders

Even though day trading can be really exciting, it is also quite tricky and can be emotionally overwhelming.

It is best to join a community of retail traders and ask them questions. Consult them whenever necessary, learn new strategies, and receive some expert insights and alerts about the stock market. But don't forget that you also need to contribute to the community.

You can also talk to each other and share screens and platforms so you can watch each other as you trade. It can be a fun, interactive environment, and you can learn from each other. Through this, you can gain more knowledge and experience in day trading.

You will meet experienced traders in an online community from whom you can learn much, and you can also help other newbie traders in exploring this lucrative business.

If you join an online community, you will see that other day traders lose money often. It can make you feel good to see that losing trades is quite common in this area, and everyone, including seasoned traders, still loses money in the process.

Bear in mind that you need to be an independent thinker. Basically, people may change when they join groups. They become more impulsive and unquestioning, nervously looking for a leader whose trades they can mimic. They respond with the crowd rather than using their own minds.

Members of the online community may be influenced by some trends, but they could lose a lot of money if the trends suddenly reverse. Don't forget that successful traders are usually independent thinkers.

You must develop good judgment so you can decide when to trade and when not to trade.

Chapter 11. Designing Your Trading Strategies

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Imagine you just started your own business and want to branch out into an entirely new market. What do you do? First, you need a strategy. But where do you start designing your trading strategies?

Where to Start?

The answer is to start looking for the best site for your research. You will then have a place to go back whenever you want to re-do the research or go in a new direction. Without this, all of your efforts are wasted; you'll be starting from scratch each and every time. However, with a choice location that contains all of your accumulated data and notes in one spot, when you get an idea, it's just a single step away from putting it into action!

What Is the Best Site?

There are dozens of sites out there that present market information in different ways. Finding the best one for you will depend on what information you want and how it's presented. Find the best site for you by focusing on the following:

- All of the data you're interested in is presented in an easy-to-use format. Keep track of a lot of different information? Make sure that you can get all of it quickly and easily.
- The site is well organized and its data is presented in a clear manner. If everything isn't there, it's easy to find what is missing and add it to your list of what's needed.
- The site has a good selection of tools for analyzing the data, like charts, indicators, drawing tools, etc. These can help you see the information and draw conclusions that might not be obvious at first glance.

-
- The site is easy to use so you aren't wasting a lot of time getting started. It should also have good options for keeping your information private; you don't want everyone else on the Web knowing what your plans are!

What Broker Do I Use?

Your broker is just as important as your research site, if not more so. If you open an account with the wrong one, the problems probably won't stop at just trading issues either. Here's an introduction to some of the things that you need to find out about any broker before committing:

- **Regulation.** You need to know if your broker is regulated by any of the banking or regulatory agencies in your country. This shows that they have to follow strict guidelines and provide assistance to you when you have a problem.
- **Regulation compliance.** If they aren't regulated, it doesn't mean that they can't be trustworthy. Just make sure that their registration is current and contact them to see what kind of assistance they provide for new traders.
- **Licensing status.** If asked for proof of licensure, the firm should be able to confirm it immediately

and without any trouble whatsoever because it should be on file with them as well as with the financial authority where the firm is located.

- **The broker should have an active online presence.** This way you can contact them whenever you need to instead of waiting for a response during regular business hours.
- **Leverage.** Make sure that your account has the available leverage that you want. This will help make trading easier and less costly when profits are made, but it also has the opposite effect when losses are suffered.
- **Fees and commissions.** Brokers typically charge either fees or commissions on every trade, or both, so find out how much each one is. Also find out how they handle any additional costs such as exchange rates when international trades are made and extra fees for electronic payments like credit cards or debit cards, etc...

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- **Binaries.** Look at how the broker handles the buying and selling of options, futures, and spot metals, and other instruments. Sometimes there are restrictions to what you can trade with one particular broker; it's a good idea to find out which ones work best for your needs, as well as costs.
 - **Order flow.** The order flow will show you how much liquidity each broker has available at any given time so that you don't have to worry about getting filled or left out of a trade on your way up or down in a market.
 - **Risk/reward ratio.** This is the amount of money you can expect to make per unit of risk involved when trading with the broker. The higher the number, the better; anything above 1.00 is considered a good risk/reward ratio.
 - **Deposit and withdrawal methods.** Each broker has its own method of handling deposits and withdrawals; you need to find out what is available to you so that there are no delays or surprises when you either deposit money or want it back!
 - **Online trading tools.** Different brokers will offer different things on their online trading platforms, so you need to see what's available and how easy it is to use. Some of these might include charting

programs, research tools, or other things that help with your analysis.

- **Trading restrictions.** Some brokers are limited as to which instruments or strategies you can trade. This will vary and be based on your location, so look for something that fits your needs.

Your research and broker will help you make sound decisions when choosing to get involved in foreign currency trading where you can plan and execute trades more easily than ever before. Don't take any shortcuts and don't settle for anything less than the best when it comes to these 2 important aspects of Forex trading.

Chapter 12. Structuring Your Analysis Framework

What Is a Technical Analysis Framework

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ur technical analysis framework is our personal set of rules and guidelines for analyzing the market. Personal is a keyword here. What I'm going to present to you is my personal guidelines on how to structure a good framework, from that you can take what works for you and ignore what doesn't.

Here are the different components of my technical analysis framework:

- Trend analysis framework
- Support and resistance framework
- Secondary frameworks
- Selecting timeframes

First, I like to create a trend analysis framework, this gives me the ability to consistently determine the state of the market. Every single time I open a chart, I will use the same strategies to determine what the trend is doing. Then, we're going to talk about creating a support and resistance framework, when I select a level as a support and resistance I want to be randomly assigning value to it every single time. I want to be able to value these levels in a consistent manner. Then, I'm going to go over potential secondary frameworks you can use in conjunction with the core trend analysis and support and resistance frameworks I like to use. And then, finally, we'll talk about selecting timeframes.

Structuring Your Trend Analysis Framework

Step 1. Select Your Primary Tools

- **Moving averages - Which moving averages? How many?** Moving averages are one of my favorite tools for analyzing trends and I did a very in-depth lesson explaining how to use these tools so if you wish to include moving averages in your trend analysis framework you need to select which moving averages you want to use and how many.
- **Candlestick analysis.** Those of you who are a bit more discretionary as traders may want to incorporate candlestick analysis in your framework.
- **Fibonacci retracements.** Fibonacci retracements are very useful in conjunction with moving averages and candlestick analysis.
- **Volume and open interest.** Volume and open interest can be useful tools as well.
- **Any other tool you enjoy using for trend analysis.** Finally, do not forget you can use any other tool you enjoy using for trend analysis, even ones I have not covered in this book. There is no right or wrong way to do this, initially, we want to build consistency above everything.

Step 2. Create Your Frameworks

Once we've chosen the tools we're going to use, we're going to create the framework itself. In example 1, I'm going to present to you a very simple framework using only moving averages.

Example 1: Simple moving average framework. I'll be using MA20, MA50, and MA100.

Moving Averages	20>50>100	20~50>100	20~50~100	20~50<100	20<50<100
Trend	Bullish	Bullish-Neutral	Neutral	Bearish-Neutral	Bearish

I've selected 3 moving averages: the 20, the 50, and the 100. Now every single time I open the chart I will have a consistent way of determining the market conditions. I will know if the 20 is above the

50 and it's above the 100 that the trend is bullish. I'll know if the 20 and 50 are crisscrossing or there isn't much distance between them but they're both above the 100, the trend is a rather weak bullish trend, so bullish-neutral bias. In an instance where the 20, the 50, and the 100 are crisscrossing and there's no clear trend I'll know it's neutral. In an instance where the 20 and the 50 are crisscrossing below the 100, I'll know there's a bearish-neutral trend. And if the 100 is above the 50 and the 20 is below the 50, I'll know there is a strong bearish trend. This would make it extremely easy for me to record trades, it'll make it extremely easy for me to backtest trades because it's consistent and I can do the same thing every single time.

Now, let's take a slightly more complicated example. Say your system is extremely sensitive to the current market conditions, you may want to introduce more variables.

Example 2: Moving averages + Open interest framework. I'll be using the MA20, MA50, and MA100.

Moving Averages	20>50>100	20~50>100	20~50~100	20~50<100	20<50<100
Open Interest Increasing	Strong-Bullish	Bullish	Neutral	Bearish	Strong-Bearish
Open Interest Decreasing	Bullish	Bullish-Neutral	Neutral	Bearish-Neutral	Bearish

Last time we had 5 different market conditions. By adding open interest alongside moving averages, we now have 10 different market conditions. When open interest is confluent with our moving averages, we assign more

strength to the argument. I hope you can see how this framework allows us to be consistent.

Here are a few more possible combinations you can play around with to decide which ones you want to use:

- Moving Averages + Fibonacci (+ Open Interest/Volume)
- Candlestick Analysis + Fibonacci (+ Open Interest/Volume)
- Moving Average + Candlestick Analysis

You can combine moving averages with the Fibonacci retracement tool if you want even more complexity, add open interest and volume on top of that. You can combine candlestick analysis with the Fibonacci retracement tool. You can even combine moving averages with candlestick analysis. Your only limitations are your creativity and your understanding of the tools themselves.

Structuring Your Support and Resistance Framework

This is going to be a bit more difficult than our trend analysis framework because there is a lot more discretion when it comes to this.

Step 1. Select your Value System

I like to go about a support and resistance framework by creating a value system, so I use different things such as the number of data points, quality of data points, the length of time of an argument, psychological levels, and you can use any other factors you deem important to create a value system.

In an example now I'll show you how this value system would work in practice. We're going to analyze the \$9,500 to \$9,300 support area marked out over here:



First, we're going to calculate the number of data points. I'm going to add one point for every data point there is then I'm going to subtract one point for every deviation.

Number of Data Points (Max 10)

- +1 for Data Point
- -1 for Deviation

Let's look at the data points in the picture (8.1), we have point (1) where it acted as a resistance before it flipped, then we have points (2), (3), (4), (5), (6), and (7); seven data points. I don't see any data points which disagree with this level so no points are taken away for deviation. That leaves us with +7 points for seven data points. Next, quality of data points, I'm going to subtract 1 for a messy point and I'm going to subtract 1 for weak context.

Quality of Data Points

- -1 for Messy Point
- -1 for Weak Context

(2), (3), (4), (7), these 4 points are messy in my opinion because these don't quite reach the support area and the points (3) and (4), while they didn't close below our region the wicks did go through. We're going to subtract 4 points because they aren't clean data points. Next, we're going to subtract some points for

weak context, if you remember it's what happens after we interact with our level, at points (a), (b), (c), (d) the price is progressively getting lower and lower every time. These data points are quite significant for me I'm going to use my discretion, subtract an extra 1 point for weak context. That puts us at -5. Next, the length of time of an argument.

Length of Time of Argument (Max 3)

- Discretionary point

I'm going to set the max for 3 points and it's going to be discretionary. This support area is held for several months, it's longer than the average support area I tend to analyze so I'll be giving 2 discretionary points for the length of time of argument. That puts us at +2. Then psychological levels.

Psychological Levels (Max 2)

- Discretionary points

I don't see \$9,500 and \$9,300 as a key psychological level, so I won't be adding any points for that. So, that leaves us with a final score = 4/10. This is without a doubt an area of support but it is below average in strength. This is an example I've come up with to show you guys how you can create a value system. By this point in the book, hopefully, your intuitive understanding of the data will let you create your own value system and through this, we have a consistent method of assigning value to our support and resistance arguments.

Step 2. Select Your Confluence Indicators and Assign a Value System to Them

Now that we have our base value system, we can expand it a bit more. We can use certain indicators that can be confluent with our support or resistance levels and

incorporate them as complementary parts of the value system.

- Moving averages
- Fibonacci
- Anything else you'd like to include

Step 3. Select your Invalidation and Break Conditions

Now, we have our base value system, we need to determine our invalidation and breaking conditions. Under what conditions will we consider a support or resistance level broken?

-
- 1-2 candles close above your level?
 - Candle close with increasing open interest/volume?
 - Candle close and moving average cross?
 - Candle close and without a retrace greater than 0.238?

You can see now why there's a lot of work to be done in this lesson. You need to sit down and create your own framework and if you don't understand the tools well enough to come up with your own then you're not ready to create your framework yet. Do not build your trading on a weak foundation, take the time to understand what you're doing.

Next, under what conditions do you no longer consider a support or resistance level significant? Will it be a failure to retest after it's broken or would it be when your value system drops to 0 so when your argument drops to 0 you no longer consider that level significant?

- Failure to retest after being broken?
- When does the value system drop to 0?

I'm just giving you ideas here, the end result has to be something you've come up with yourselves. With that, you will have a framework for analyzing support and resistance levels.

Secondary Frameworks

Let's cover some secondary frameworks you can use alongside your primary ones. For those who wish to complicate their analysis further. You could include a framework using oscillators like the relative strength index or Bollinger bands. You can use Elliott Wave theory if that appeals to you. Some traders like to study statistics on certain months of the year, days of the week, or times of the day and incorporate that into their systems. Also, if you're trading multiple similarly behaving assets you should have a system for analyzing liquidity to make sure the market has enough liquidity for your orders.

Selecting Timeframes

Next, we're going to talk about selecting our time frames. While this is important for our analysis framework, it's something I'd like to cover in a lot more detail in a future psychology book because your personal psychology and lifestyle is a huge factor when deciding which time frames to trade on.

Primary Timeframe

What type of trader do you want to be?

- Day trader: 1 hour
- Swing trader: 1 hour to 1 day

I've explained to you multiple times throughout this book the difference between time frames, when you go to higher timeframes data becomes more significant, volatility decreases. At lower timeframes data is less significant and volatility increases so you're going to have a lot more opportunities on lower timeframes and you're going to have a lot fewer opportunities on higher time frames.

Personally, I like to trade on lower timeframes, I'll get into positions multiple times a day. I don't like waiting extended periods of time for positions to close because I cannot stop thinking about a position once I am in it.

This is why psychology is extremely important when trying to select your time frame but for the purpose of this book, you can select what timeframes you like based on what type of trader you want to be. Do you want to be a day trader and trade timeframes under 1 hour? Do you want to be a swing trader trade timeframes from the 1 hour to say the 1 day or do you want to be an even longer time frame trader and trade weekly and monthly charts? That's up to you.

Experiment with both and decide which one you want to use and then I'd recommend selecting 2 complementary timeframes.

Complementary Timeframes

- Higher timeframes for trend analysis
- Lower timeframes for pinpointing support and resistance invalidations/breaks

Now a higher timeframe can be extremely useful for trend analysis and also pinpointing significant support and resistance levels. Then you also want a lower timeframe to complement this help and help pinpoint support on resistance and validations and breaks.

Putting It All Together

Now, we put it all together, here's your checklist:

- Analysis timeframes
- Trend analysis
- Support and resistance analysis
- Secondary analysis

You want to select your analysis timeframes. You want to have a trend analysis framework that you can perform on these timeframes. You want to have a support and resistance analysis framework. A value system in which you can assess the importance of different support and resistance levels and you can accompany this with any secondary analysis tools you want and you will go through this checklist every single time you analyze the market. This is a complete technical analysis framework.

Once you have built your technical analysis framework, congratulations! You have completed my technical analysis foundation book. Your next task is to translate your technical analysis framework into a trading system. You will use your framework to come up with a hypothesis for entry and exit strategies. You will then test these in the markets and attach correct risk management to them. Once your data shows that you are profitable you can then enter the market with your strategy.

Components of a Trading System

- **Psychology:** Without the mental framework to execute your trades, even the best system in the world is useless.
- **Risk management:** Every system is vulnerable to failure. A system will most likely be wiped out before it can earn money if it does not have long-term risk management.
- **Entry:** The least important part of a system. Choosing the best market circumstances to enter a trade.
- **Exit:** Exits are used to maximize winners and minimize losses. Often overlooked and far more important than specific entries.

Chapter 13. School of Indicators

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oreign indicators are frequently used by traders to increase their chances of profiting on the foreign exchange market while trading. Indicators,

like other types of data and analysis, can influence trading decisions and serve as the foundation for Forex trading strategies. By analyzing historical market behavior and patterns, traders may be able to use the best Forex indicators to forecast how the market will behave in the future and, consequently, which trades are likely to be profitable.

What are currency market indicators? Before trading on a platform, Forex traders analyze a variety of data points to determine how the market is performing and how it is likely to change in the future. Traders should be able to employ more effective trading strategies and earn a higher return with detailed market analysis.

Indicators for Forex trading are one method of examining market data. Indicators use historical data, such as currency prices, volume, and market performance, to forecast how the market will

behave in the future and which patterns are likely to repeat. Once traders have access to this information, they can make more informed trading decisions and potentially earn a higher return.

There are numerous different types of Forex indicators, and it's beneficial to understand what each one does before trading. The most frequently used Forex indicators are as follows:

Trend indicators:

- Average directional indicators
- Moving averages
-

Parabolic

Momentum

indicators:

- Relative strength index
- Moving average

convergence divergence

Volatility indicators:

- Bollinger Band strategy
- Average true range
- Volume indicators

With so many different types of Forex indicators available, you may be unsure where to begin. This book can assist you in mastering the more technical aspects

of trading. The best Forex indicators operate on the premise that historical patterns are likely to repeat themselves when similar circumstances arise. Rather than viewing the foreign exchange market as a random series of events, Forex indicators look for patterns in the market's specific behavior.

If a currency fell immediately following a political crisis, for example, this could have occurred as a result of repeated episodes of political instability. If this is the case, Forex indicators will record this information and use it to forecast whether or not the same behavior will occur in the future. By

gaining access to this data, traders can gain insight into the factors that influence currency prices and the market as a whole and trade accordingly.

Forex indicators can be used to:

- Conduct technical analyses
- Contribute to risk minimization
- Establish a foundation for your trading strategies

Is it necessary to use Forex indicators? Technical instruments and sophisticated data are not only for seasoned traders and professional analysts. Indeed, indicators serve as a means of simplifying extremely complex and voluminous data, and anyone can benefit from their use. These indicators are an integral part of forex traders' daily routines while trading and play a significant role in their decision-making process. The more knowledge you have about the market, its operation, and the variables that influence it, the more informed you will be. By making trading decisions based on historical market activity and informing your trading strategy with previous currency patterns, you can increase your returns and profits.

How do you gain access to foreign exchange trading indicators? With so many indicators available, it can be difficult to determine which indicator is the best or most important for your trading needs. While a variety of indicators can be used to examine market behavior and

forecast future market events, you may not want to use every Forex indicator when you first begin. By working with the best Forex broker, you can ensure that you have access to a variety of resources, including Forex indicators, Forex signals, and a Forex calendar. When you use multiple tools to develop a trading strategy, you take into account more variables, which may provide you with a more accurate picture of how the market will perform.

Access to Forex indicators is critical to trading success, so you'll want to ensure that your chosen broker offers in-depth market analysis and a variety of tools. Similarly, you may wish to choose a

broker that offers a variety of potentially beneficial trading features, such as Forex signals and the best Forex trading app.

Along with access to Forex indicators and market data, the best Forex broker for you may offer Forex glossaries, coaching, and curated investments, as well as support during both Forex trading hours and non-trading hours.

Forex technical indicators are classified into 4 broad categories: trend, momentum, volatility, and volume, and are used to generate a technical analysis of the foreign exchange market. Technical indicators make quick calculations and then plot the results on a convenient graph. You can avoid time-consuming, complex mathematical calculations by utilizing these technical indicators, such as the moving average convergence divergence indicator, the relative strength index, or the Bollinger Bands.

Forex technical indicators generate simple-to-understand data that serves as a great visual guideline for past trends and potential future market activity, making it easier for traders to take action.

Choosing Indicators and Brokers for Forex

Choosing the right Forex indicators is just as critical as choosing the right broker. By incorporating various

indicators into your trading strategy, you can increase your chances of success, and by carefully selecting Forex indicators and brokers, you can practice risk management and maximize your potential returns. For instance, choose a broker that offers all the tools and functionalities you require.

PayPal Forex brokers may make it simple to fund your account, and brokers that offer 24-hour support may provide you with the reassurance you require when you begin trading. Many people want to know what Forex leading indicators are, as they can appear quite complicated at first glance. However, the rationale for using Forex indicators is quite straightforward. Prior to making any trading decisions or transactions, you should gather as much information as possible. Knowing

which events impacted the market in the past and the magnitude of their impact can aid in forecasting future market behavior. If you have a crystal-clear picture of what will happen to currency prices and the FX market in general, you should have a better chance of selecting the optimal entry and exit points and executing profitable trades.

Moving Averages

Moving averages are a widely used technical indicator in the Forex market. As popular as moving averages are, one question remains at the top of the list for the majority of traders—"How to make the most of moving averages?"

We will discuss what moving averages are and how to use them effectively. Additionally, we will discuss some of the drawbacks to moving averages that all traders should consider before incorporating them into their trading strategy.

Let's begin with answering the question, what is a moving average calculator?

To begin, it's worth noting that the moving average is a lagging indicator. This indicates that it is based on previous price movements. Moving averages are classified into 2 types: simple moving averages (SMA) and exponential moving averages (EMA). The simple

moving average, as the name implies, is a simple average of a currency pair's movement over time. On the other hand, the exponential moving average gives greater weight to recent price action.

I prefer exponential over simply because I believe it provides a more accurate picture of what is occurring rather than what has occurred.

Moving averages can be used in a variety of ways, but the 3 methods below are my personal favorites. Because the moving average is a lagging indicator, it should always be used in conjunction with other price action patterns and signals to help you improve your odds.

Analyze Trends

Moving averages are arguably the most frequently used indicator for trend analysis. There are numerous moving average combinations that a trader can use to analyze a trend, but my favorite is the 10 EMA and the 20 EMA.

As is the case with the majority of things in the Forex market, using moving averages to analyze trends is not an exact science. Nor is it something on which you want to rely solely. However, when used properly, these 2 moving averages can significantly simplify the process of identifying a trend. Consider the following example.



Observe how we are only looking for buying opportunities in the AUDUSD daily chart above when the 10 EMA is above the 20 EMA. Because the 10 EMA is more closely related to price action than the 20 EMA, when it is on top, it indicates that the market is in an uptrend.

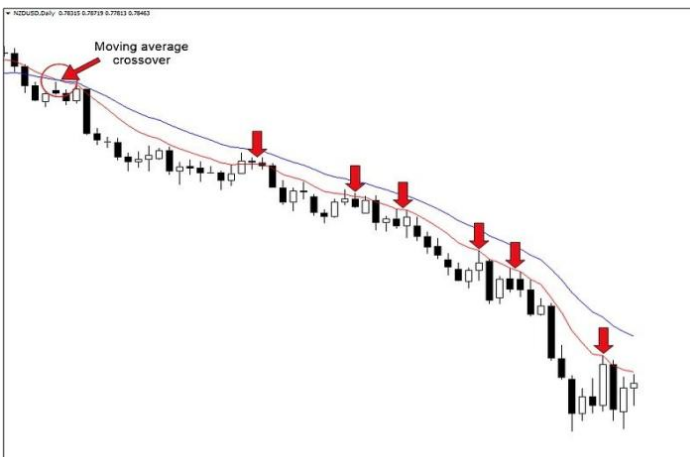
On the other hand, when the 10 EMA is below the 20 EMA, we want to look for selling opportunities only, as this frequently indicates the start of a downtrend.

Support and Resistance in Dynamic Modes

Additionally, these 2 moving averages can act as dynamic support and resistance. Several moving averages carry more weight in the market than others, including the 10 and 20 period moving averages. The following is a list of the 5 most frequently used moving averages by Forex traders:

- 10
- 20
- 50
- 100
- 200

Due to the frequency with which the periods above are used, the market tends to respect them more than others. That is why support and resistance levels work in the market—if a sufficient number of traders use the same level to buy or sell a market, the market is likely to react accordingly. Consider the 10 and 20 EMAs as dynamic resistance levels during a downtrend.



Take note of how the 10 EMA began to act as dynamic resistance once it crossed below the 20 EMA. When combined with a price action sell signal, this type of dynamic resistance can be extremely powerful.

Identifying Excessively Extended Markets

Finally, but certainly not least, moving averages can be used to determine whether a market is overextended. Forex traders frequently make the error of buying or selling too late. We want to avoid investing in overbought markets, and moving averages can assist us in determining whether this is the case.

It's worth noting that this method is complementary to the use of moving averages as dynamic support and resistance. This is an illustration of how to use moving averages to avoid selling into an overbought market.



On the daily chart of the NZDJPY, the market made 2 extended declines away from the 10 and 20 EMAs. As price action traders, our objective is to avoid entering a market that has moved significantly away from our moving averages. Rather than that, we'd like to wait for the market to normalize and return to its moving averages before looking for a sell signal to join the trend.

Relative Strength Indicators (RSI)

Additionally, we'll discuss RSI trendlines and how to trade the RSI with various strategies such as the RSI 2 Period Divergence and more. I'll then assist you in identifying additional indicators to pair with the RSI indicator in order to enhance your trading performance.

How to Trade the Relative Strength Index (RSI) Indicator

Before we discuss the best strategies and settings for day trading and intraday trading with the RSI indicator, we should review some fundamentals. Technical analysis is a technique for predicting future market trends and price movements by studying historical market charts and comparing them to current charts. Technical analysis is concerned with what has occurred in the market and what may occur in the future. It takes the price of security into account and generates charts for use as the primary tool.

One significant advantage of technical analysis is that skilled analysts can monitor multiple markets and market instruments concurrently. Before delving into the details of the RSI indicator, it is necessary to review 3 fundamental principles of technical analysis:

- The trend is your friend. Technical analysis is used to identify market behavior patterns that have been recognized as significant for a long period.
- There is a high probability that many given patterns will produce the expected results. Additionally, there are recognized patterns that are consistently repeated.
- History tends to repeat itself. For more than a century, Forex chart patterns have been recognized and classified, and the frequency with which many

patterns recur suggests that human psychology has remained relatively stable over time. Price Action offers substantial savings on everything.

This means that the current price reflects everything the market is aware of that could affect it, such as supply and demand, political factors, and market sentiment. Technical analysts, on the other hand, are only interested in price movements and not the reasons for any potential changes.

RSI—the Relative Strength Index Indicator—is one of the indicators heavily used in technical analysis. Due to the strength of its formula and the possibility of utilizing RSI divergence, RSI indicator trading has grown in popularity.

What Is the Relative Strength Index (RSI)?

The RSI calculates the ratio of upward to downward movement and normalizes the result to a range of 0-100. J. Welles Wilder invented it. The security is considered if the RSI is greater than 70. An RSI of less than 30 is interpreted as indicating that the instrument may be oversold (a situation in which prices have fallen more than the market expectations).

Contrary to popular belief, the relative strength index (RSI) is a leading indicator. 2 equations must be solved to calculate the RSI indicator. The first component equation determines the initial Relative Strength (RS) value, which is defined as the ratio of the average "Up" closes to the average "Down" closes over "N" periods, as illustrated in the following RSI formula example:

$$RS = \text{Average of "N" day's positive closes} / \text{Average of "N" day's negative closes}$$

The actual RSI value is determined by indexing the indicator to 100 using the RSI formula example below:

$$RSI = 100 - (100 / 1 + RS).$$

How to trade the RSI in the short term. Many traders find that employing the RSI indicator in their day trading strategy is extremely beneficial. The default RSI period setting is 14, which is suitable for most traders, especially swing traders. However, some intraday traders use a different setting when trading the RSI

indicator. They dislike the 14-setting because it produces infrequent trading signals. As a result, some traders choose to reduce their time frame, while others choose to decrease the RSI period to increase the oscillator's sensitivity.

Generally, intraday traders (day traders) frequently use lower settings with periods ranging from 9-11 hours. Swing traders who trade on a medium-term basis frequently use the default period setting of 14. Longer-term position traders frequently set it to a higher period, between 20 and 30 days. Which settings to use when trading with the RSI indicator depends on your trading strategy.

Setting the RSI Indicator for an Intraday Trading Strategy

Determine the most effective settings for your trading style by determining the amount of noise you are willing to process with the data you receive. Keep in mind that as you acquire experience with this indicator, regardless of the level you select, your ability to detect trustworthy signals will increase.

In the case of day trading and intraday trading with the RSI indicator, you will be making short-term trades. Traders frequently choose lower settings for all variables in this environment due to the earlier signals generated. As previously stated, short-term intraday traders typically trade with lower settings and periods ranging from 9-11.

Trading Strategies Using the RSI Indicator

You have now mastered the RSI indicator. However, you must understand how to use the RSI indicator effectively. It is now time to examine how to trade the RSI. The following are some examples of RSI indicator settings that can be used in conjunction with various trading strategies:

Levels of RSI and OBOS

With this strategy, you can predict when the price will bounce off the trendline, indicating an entry opportunity. If the RSI drops below 30, the market is oversold and may rise. A buy trade can be entered once the reversal is confirmed. If the RSI exceeds 70, the market is overbought and the price may soon fall. After confirmation of the reversal, sell. Bullish (upper) and bearish (lower) zones meet at the RSI 50 level. If the RSI is above 50, the trend is up. If it is below, the trend is down.



RSI 2-Period Divergence

This strategy is also known as an RSI 14 trading strategy. Compare the 5-period RSI to the default 14 period RSI. When using the RSI 14 trading strategy, the market may not reach oversold or overbought levels before turning. With a shorter period RSI, reversals can be detected earlier. When the RSI 5 exceeds the RSI 14, prices are rising. When the 5-period (blue) is oversold, a buy signal is generated, and a 5 vs. 14 cross should occur (below 30). When the RSI 5 falls below and then becomes equal to the RSI 14, it indicates that recent prices are declining. This is a signal to sell. When the 5-period (blue) is overbought, a 5 vs. 14 cross should occur (above 80). Experienced traders may find that combining an RSI trading strategy with Pivot Points significantly improves their trading performance.



Trend Lines of the RSI

Trade the trendline break on the RSI chart. Create an RSI uptrend line by connecting 3 or more points on the rising RSI line. A trendline is formed when 3 or more points on the RSI line fall together. Price trends may continue or reverse after an RSI trendline break. Remember that an RSI trendline break typically occurs before a price chart trendline break, providing an early warning and trading opportunity.



Divergence of the RSI Classic

RSI bearish divergence occurs when the price makes a higher high while the RSI falls and makes a lower high. RSI divergence typically forms at the peak of a bullish market, and this is referred to as a reversal pattern. When the RSI divergence forms, traders anticipate a reversal. It is a forewarning of impending reversal, as it appears in several candlesticks before the uptrend reverses and breaks below its support line.

When the price makes a lower low and the RSI makes a higher low, this is known as a bullish RSI divergence.

This is a signal that the trend may be changing from down to up.

The RSI divergence indicator is frequently used in technical analysis of the Forex market. Certain traders prefer to trade RSI divergence on higher time frames (H4, Daily). You can use these strategies to generate a variety of RSI indicator buy and sell signals.



Stochastic Indicators

I'm constantly amazed at how few traders truly understand the indicators they're using. Or, even worse, many traders misuse their indicators because they never took the time to learn them.

What Is a Stochastic Indicator (Stochastic)?

The Stochastic indicator provides insight into the momentum and strength of a trend. As we will see shortly, the indicator analyzes price movements and informs us of their speed and strength. George Lane, the inventor of the Stochastic indicator, stated that Stochastics is used to determine the price's momentum. Consider a rocket ascending into the air—before it can turn down, it must first slow down. Momentum always shifts in the opposite direction of price.

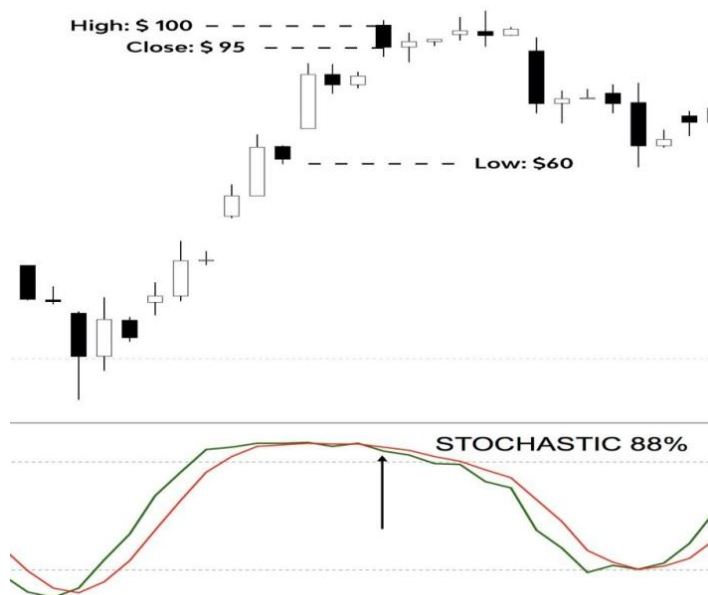
What Exactly Is Momentum?

Before we begin using Stochastic, it is necessary to understand what momentum is. Momentum is the rate at which the price of a security increases. I've always been a fan of delving into how an indicator analyzes price, and without getting too technical, this is how the indicator analyzes price:

The Stochastic indicator analyzes a price range over a specified period or number of price candles; the Stochastic indicator is typically set to 5-14 periods/price candles. This means that the Stochastic

indicator compares the period's absolute high and low to the closing price. We'll see how this works with the following 2 examples. I've chosen a 5-period Stochastic, which means that the Stochastic will only look at the previous 5 candlesticks.

When the Stochastic indicator is high, it indicates that the price closed near the top of the range for a specified time period or number of price candles.



The graph indicates that the low was \$60, the high was \$100 (a \$40 range), and the price closed almost exactly at the top, at \$95. The Stochastic indicator is at 88%, indicating that the price closed only 12% (100% - 88%) below the absolute top.

How to calculate a high Stochastic:

- The 5 candles' lowest low: \$ 60.
- The 5 candles' highest point: \$ 100.

- The previous candle's close: \$95

The Stochastic indicator's value is $[(95 - 60) / (100 - 60)]$
 $88\% \times 100$

As you can see, the high Stochastic indicates that the price was extremely strong over the previous 5 candles and that recent candles are pushing higher. In contrast, a low Stochastic value indicates that the downside momentum is strong. As shown in the graph, the price closed only \$5 above the range's low of \$50.

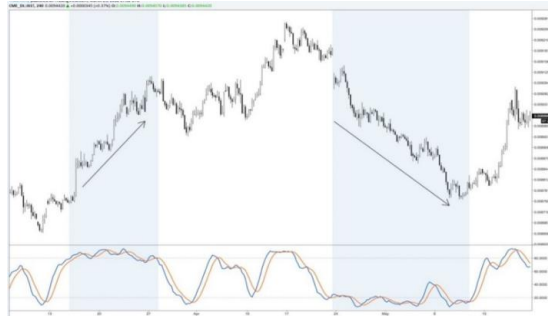


Calculate the Stochastic

- The 5 candles' lowest low: \$ 50.
- The 5 candles' highest point: \$ 80.
- The previous candle's close: \$55
- The stochastic indicator's value is $[(55 - 50) / (80 - 50)] * 100 = 17\%$

Stochastic of 17% indicates that price closed only 17% above the range low, indicating that downside

momentum is very strong.



Stochastic Signal

Finally, I'd like to outline the most frequently used signals and strategies for traders to employ the Stochastic indicator:

When the Stochastic suddenly accelerates in one direction and the 2 Stochastic bands widen, this can indicate the start of a new trend. Even better if you can also identify a breakout from a sideways range.



- **Following the trend:** As long as the Stochastic remains crossed in one direction, the trend is still valid. When the Stochastic oscillates between oversold and overbought levels, avoid fighting the

trend and instead attempt to hold onto your trades
and ride the trend.

-
- **Strong trends:** At this point, the Stochastic is in the overbought/oversold area, at this point try to stick to the trend.



- **Trend reversals:** When the Stochastic oscillates in a new direction and moves away from the overbought/oversold areas, this may indicate a trend reversal. As we shall see, the Stochastic can also be used effectively in conjunction with a moving average or trendlines. In order to identify a bullish reversal, the green Stochastic line must cross above the red one and exit the overbought-oversold area.
- **Divergences:** As with any momentum indicator, divergences can be a critical signal, in this case, indicating potential trend reversals or, at the very least, the end of a trend.



Using the Stochastic in Conjunction with Other Tools

As with any other trading concept or tool, the Stochastic indicator should not be used in isolation. To obtain meaningful signals and to enhance the quality of your trades, you can combine the Stochastic indicator with the following 3 tools:

- **Moving averages:** They are an excellent addition to this strategy because they act as filters for your signals. Always trade in the direction of your moving averages and look for longs only when the price is above the moving average and vice versa.



- **Price formations:** As a breakout or reversal trader, you should search for wedges, triangles, and

rectangles. It may suggest a good breakout if the price breaks out of this pattern with an accelerating Stochastic.

-
- **Trendlines:** Stochastic divergence and reversal, in particular, can be traded effectively with trendlines. You must first identify an established trend with a valid trendline and then wait for the price to break it with Stochastic confirmation.



While you may not require the Stochastic indicator if you are able to read the momentum of your charts simply by looking at the candles, it certainly does not hurt to have it on your charts if the Stochastic is your preferred tool (this goes without a judgment whether the Stochastic is useful or not).

Additionally, traders share a great deal of incorrect information, and even widely used tools such as the Stochastic indicator are frequently misinterpreted by the majority of traders. Do not believe everything you hear; conduct your own research and expand your trading knowledge.

Bollinger Bands

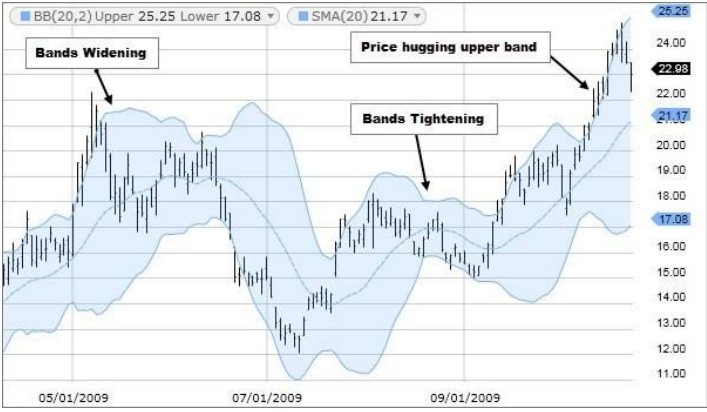
Bollinger Bands are envelopes drawn at a standard deviation above and below the price's simple moving average. Because the bands' distances are based on standard deviation, they adjust to changes in the underlying price's volatility.

These bands are defined by period and standard deviation (StdDev). The default values for a period and standard deviation are 20 and 2, respectively.

Bollinger Bands assist in determining whether prices are relatively high or low. They are used in pairs, with upper and lower bands, and with a moving average. Additionally, the pair of bands is not intended to be used independently. Utilize the pair to validate signals generated by other indicators.



The likelihood of a significant price movement in either direction increases when the bands compress during a time of low volatility. Volatility rises when the bands grow exceptionally wide apart, and any current trend may come to an end. Prices have a tendency to bounce around within the bands' envelopes, touching one and then going to the other. These fluctuations can be utilized to help locate possible profit targets. The upper band becomes the profit objective if the price rebounds off the lower band and subsequently crosses above the moving average.



Price can stretch beyond or hug the band envelope for lengthy periods of time during strong trends. When a momentum oscillator reveals divergence, you may want to do further study to see if taking extra profits is a good idea for you. A significant trend continuation is anticipated if the price breaks out of the bands. If prices quickly return back within the range, however, the indicated strength is lost.

Calculate a simple moving average first. Calculate the standard deviation across the same number of periods as the simple moving average. For the upper band, multiply the moving average by the standard deviation. The lower band is obtained by subtracting the standard deviation from the moving average. Typical values include the following:

- **In the short term:** We use a 10-day moving average with bands of 1.5 standard deviations. (1.5 times the standard deviation plus or minus the SMA). In the medium term, a 20-day moving average with bands of 2 standard deviations is used.
- **In the long term:** 50-day moving average, 2.5-standard deviation bands.

Moving Average Convergence Divergence Indicator

The MACD formula is as follows:

- MACD Line: (12-day exponential moving average - 26-day exponential moving average)
- MACD Line's 9-day EMA serves as the signal line.
- Histogram of MACD Lines: MACD Line - Signal Line

You're most likely thinking, "It's far too complicated, and I have no idea what it means." Avoid fleeing. Because I'm about to deconstruct the MACD formula into manageable chunks that even a 10-year-old can comprehend. That sounds reasonable? Then continue reading...

Step by Step De-Mystification of the MACD Indicator

You may now be wondering: "What are the optimal MACD settings?" To be honest, there is no optimal setting because it does not exist. And for this book, I'm going to use MACD's default settings. With that in mind, let us dissect the MACD indicator (step by step). It'll be simple, I assure you.

1. *MACD Line*

Simply subtract the 12-day EMA from the 26-day EMA (you can find it on your charts with zero calculations). Additionally, poof! This is the MACD Line. Here is an illustration:



I told you it was simple, correct?

2. *The Signal Line*

This becomes even simpler. Simply divide the MACD Line's historical value by nine. That's it; you now have your Signal Line.

Assume you have a MACD Line with these values, a, b, c, d, e, f, g, h, add the numbers together (which equals 45), and divide by nine. As a result, you'll obtain $45/9 = 5$.

3. *Histogram of the MACD*

This is ridiculously simple (to the point of being comical). Simply subtract the MACD Line's value from the Signal Line.



That is the MACD Histogram for you. This is what I mean. You may now be wondering, "So, which MACD indicator settings are optimal?" There is no such thing as the optimal MACD settings due to the market's constant movement. What works best at the moment is unlikely to continue to work in the future.

Thus, the critical point is not to optimize for the optimal MACD indicator settings—such a thing does not exist. Rather than that, you should understand the MACD concept in order to apply it to your trading needs.

Frequently Made Errors: How NOT to Use the MACD Indicator

Allow me to share 2 common errors traders make when utilizing the MACD indicator. They are as follows:

MACD Crossover Trading

This technique may be effective in markets that are strongly trending. However, bear in mind that the markets spend the majority of their time in a range. This implies that the MACD crossover will generate numerous false signals, resulting in "death by a thousand cuts."



There are now more effective ways to employ the MACD crossover (but more on that later).

MACD Histogram Misinterpretation



You're most likely thinking: "There is considerable momentum behind the movement. It is time to purchase!" Wrong! Because when such a move occurs, it is frequently too late to enter, and the market will almost certainly reverse. Rather than that, a better strategy is to trade against the trend—and profit from the reversal.

How to Interpret the MACD Histogram and Spot Momentum Reversals

When I first began trading, I enjoyed "chasing" breakouts. The more bullish the candles, the more likely it is that I will purchase the breakout. However, I was hemorrhaging money from my account. That's when I realized I'd entered my trades "late." I purchased when the price was on the verge of reversing direction. This resulted in an AHA moment.

I was curious. "What if I abandoned my pursuit of breakouts?" "How about I took the other side of the trade?" "What if I look for opportunities to short during periods of strong bullish momentum?" It worked significantly better! However, I had difficulty explaining what strong momentum is to traders. So, this is where the MACD histogram is useful.

- Allow time for the price to enter the market structure (like SR, trendline, etc.)
- The MACD histogram demonstrates significant momentum (you want to see a high peak/trough).
- Prior to trading in the opposite direction, wait for price rejection.

Chapter 14. The Best Trades: Putting It All Together

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he market is linear—it can only go up or down. When you plot it on a conventional chart with time on the horizontal axis, you add a second dimension, but the market itself is the only price, which means that it has only one dimension. You can make bull and bear

bodies have different colors, incorporate volume into the widths of the bodies, or add all kinds of indicators, increasing the number of dimensions, but the market itself is one-dimensional. The recurring theme of these books is that the market is basically simple. It moves up or down because it is constantly searching for the best price, which changes constantly because of unending changes in countless fundamentals. The fundamentals are anything that traders feel is important and include data on every stock, the overall market, politics, natural and manmade events from earthquakes to wars, and international factors. This results in the market always trying to break out from a trading range (its current area

of agreement on the value of the market) into a trend, as it searches for the appropriate instantaneous value for the market. If the breakout is to the upside, the bulls are momentarily successfully asserting their opinion that the market is too cheap. If there is instead a downside breakout, then the bears at least briefly are winning their argument that the market is too expensive. Every breakout attempt is met by traders holding the opposite belief, and they will try to make the breakout fail and the market reverse. This is true on every time frame and on every bar and series of bars. The trading range can be a single bar or a hundred bars, and the breakout can last 1 bar or many bars. The key to trading is developing the ability to assess whether the bulls or bears are stronger. When a trader believes that the odds favor one side over the other, they have an edge. The "odds" refers to the trader's equation. An edge (positive trader's equation) exists if the probability of trade reaching their profit target before hitting their protective stop is greater than the probability of the market hitting their stop before reaching their target.

Having an edge allows them to make money by placing a trade. Every type of market does something to make trading difficult. The market is filled with very smart people who are trying as hard to take money from your account as you are trying to take money from theirs, so nothing is ever easy. This even includes making profits in a strong trend. When the market is trending strongly with large trend bars, the risk is great because the protective stop often belongs beyond the start of the spike. Also, the spike grows quickly, and many traders are so shocked by the size and speed of the breakout that they are unable to quickly reduce their position size and increase their stop size, and instead watch the trend move rapidly as they hope for a pullback. Swing traders are often uncomfortable entering on the spike because they prefer trades where the reward is 2 or more times the size of the risk. They are willing to miss a high-probability trade where the reward is only equal to the size of the risk.

Once the trend enters its channel phase, it always looks like it is reversing. For example, in a bull trend, there will be many reversal attempts, but almost all quickly evolve into bull flags. Most bull channels will have weak buy signal bars and the signals will force those bulls who prefer stop entries to buy at the top of the weak channel. This is a low-probability long trade, even though the market is continuing up. Swing traders who are comfortable taking low-probability buy setups near

the top of weak bull channels love this kind of price action because they can make many times what they are risking and this more than makes up for the relatively low probability of success.

However, it is difficult for most traders to buy low-probability setups near the top of a weak bull channel. Traders who only want to take high-probability trades often sit back and watch the trend grind higher for many bars, because there may not be a high-probability entry for 20 or more bars. The result is that they see the market going up and want to be long, but miss the entire trend. They only want a high-probability trade, like a high 2 pullback to the moving average. If they do not get an acceptable pullback, they will continue to wait and miss the trend. This is acceptable because traders should always stay in their comfort zone. If they are only comfortable taking high-probability stop entries, then they are correct in waiting. The channel will not last forever, and they

will soon find acceptable setups. Experienced traders buy on limit orders around and below the lows of prior bars, and they will sometimes take some short scalps during the bull channel. Both can be high-probability trades, including the shorts if there is a strong bear reversal bar at a resistance level, and some reason to think that a pullback is imminent.

Once the channel phase ends, the market enters a trading range, where there are many strong bull spikes that race to the top and strong bear spikes that race to the bottom. Traders often focus on the strong spike and assume that the breakout will succeed. They end up buying high and selling low, which is the exact opposite of what profitable traders do. Also, the reversals down from the top and up from the bottom usually have weak signal bars, and traders find it hard to take the entries that they have to take if they expect to make money in a trading range. Within a trading range, the probability for most trades hovers around 50%, and only occasionally gets to around 60%. This means that there are few high-probability setups. Also, lots of low-probability events happen, like reversals that don't look good but still lead to big swings and no follow-through after strong spikes.

All of this makes it sound impossible to make money as a trader, but if you go back to each relevant section, you will remember that there are profitable ways to trade the market, no matter how it is behaving. Your edge is always going to be small, but if you are a careful,

unemotional, and objective reader of the chart in front of you, and only look to take the best trades, you are in a position to make a living as a trader.

There are traders trading for every reason and on all time frames at every second on every chart. What generalities can be made about how discretionary traders, whether institutional or individual, will trade a bull trend? A bull trend begins with a breakout, which is a spike up and can contain one or many bull trend bars. If the breakout fails, the market will fall back into the trading range, and traders will fade the breakout (it will be a final flag reversal) and continue to trade the trading range. When a breakout is strong and successful, most discretionary traders will buy with a sense of urgency. They will buy at the market, on small pullbacks, at the close of the bar, and above each prior bar. Once the market transitions into a channel, they will buy below the low of the prior bar,

like below low 1 and low 2 signal bars, expecting reversal attempts to fail (in a trend, most reversal attempts fail), and above the high of the prior bar, like above high 1, high 2, and triangle buy setups. They will then buy pullbacks from the breakouts of these small bull flags. They will even buy the first breakout of a bear microchannel in a strong bull trend, knowing that there might not be a breakout pullback setup until after the market has rallied many bars.

Early on, when the trend is strong, they will buy on new breakouts above prior swing highs, but as the 2-sided trading (selling pressure) increases, as seen by more and larger bear trend bars and more bars with tails on their top, traders will begin to sell above prior swing highs. Most will be selling to take profits on their longs, but as the slope of the channel becomes flatter and the pullbacks become deeper, more traders will start to short above swing highs, looking for scalps.

When the 2-sided trading increases to the point that the bears are about as strong as the bulls, traders will see the market as having entered a trading range. This means that they are much less certain that the trend will resume on each rally attempt (they no longer are looking for pullbacks in a strong bull trend, where the breakout usually quickly tests the old high). They will buy low, sell high, and most will scalp. They will look for high 1 and high 2 buy setups near the top of the range and will short above the signal bars, instead of buying up there. At

first, they will only look for scalps, like pullbacks to the moving average, the bottom of the trading range, or the bottom of the bull channel. Once they see increasing selling pressure, they will begin to swing some and eventually all of their shorts, and will only look to buy deep pullbacks, lasting 10 or more bars and having 2 or more legs.

After there have been one or more pullbacks where the selling was strong enough to break below the trend line and below the moving average, some bears will look to short the test of the bull trend high, expecting a major trend reversal. They will short a reversal setup at a lower high, a double top, or a higher high, even though they realize that the chance of a swing down might be 40% or less. As long as the reward is much larger than the risk, they have a positive trader's equation, even though the chance of success is relatively low. Bulls will buy reasonable setups at the bottom of the

trading range, like on larger high 2 buy setups, wedge bull flags, higher timeframe trend lines, and measured move targets. Traders realize that a trading range is simply a pullback on a higher timeframe chart. When the spike and channel are steep on a 5-minute chart, they together form a simple spike on a higher timeframe chart, like a 15-60-minute chart. The trading range on the 5-minute chart is usually just a pullback on a 15-60-minute chart. When bulls buy near the bottom of a 5-minute trading range, many will hold for a swing up, a breakout to a new high, and a measured move up, even though the probability may be less than 50%. This relatively low-probability swing long has a positive trader's equation because the reward is much larger than the risk.

While in the trading range phase, signals are often unclear, and there is a sense of uncertainty. Most of the signals will be micro double bottoms and tops, and small final flag reversals. This is lower probability trading, and traders have to be careful and quick to take profits (scalp). They must force themselves to buy low and sell high, not buy strong bull spikes near the top of the range and short strong bear spikes near the bottom. Invariably, the spikes look strong, but don't overlook all of the bars before them—in a trading range, most breakout attempts fail. Once the market has entered a trading range, if a leg is in a strong microchannel, lasting 4 or more bars, don't enter on the breakout. Wait to see if the

breakout is strong. If so, enter on the pullback from the breakout. If there is a bear microchannel down to the bottom of the range, wait for the bull breakout and look to buy the pullback, whether it forms a higher low, a micro double bottom, or a lower low. If there is a bull microchannel up to the top of the range, wait to sell a lower high, micro double top, or higher high pullback. As with all trades, always make sure that there is an appropriate signal bar.

If the market enters a tight trading range, wait for the breakout, because tight trading ranges trump everything, including every logical reason to take a trade. Using stop entries in a tight trading range is a losing strategy, but the setups always look worthwhile. Instead, patiently wait for the breakout and then decide if it is likely to succeed or fail.

If there is a successful breakout of the top of the entire trading range, the process starts all over again. Traders will see the breakout as a spike and they will look for at least a measured move up.

If there is an upside breakout, but it fails and the market reverses, traders will view the trading range as the final flag in the bull trend. If there is then a breakout below the trading range, traders will evaluate the strength of the breakout, and if it is strong, they will repeat the entire process in the opposite direction. The downside breakout from the trading range can occur without first having a failed upside breakout. Instead of a final flag reversal, the trading range can be some other kind of reversal setup, like a double top, a triple top, a head and shoulders top, or a triangle. All that matters is that there is a strong downside breakout, and traders will then expect pullbacks and a bear channel to follow the bear breakout, and then the market to evolve into a trading range, which can be then followed by a bull or bear breakout.

Examples of Best Trades

- Opening reversals where the setup is strong
- Swing for a reward that is at least twice the risk: The probability of success is 50-60%.
- Scalp for a reward that is at least as large as the risk: The probability is about 60-70%.
- Strong reversals, where the reward is at least twice the risk and the probability is 50-60%.
- Major trend reversal: Following a strong break of the trend line, look for a weak trend resumption to fail

on a test of the trend's extreme; the reversal signal bar should be strong. After a bear trend, look to buy a higher low, double bottom, or lower low. After a bull trend, look to short a higher high, double top, or lower high.

- Strong final flag reversal after a swing up or down in a trading range or weak channel.
- Buying a third or fourth push down in a bear stairs pattern for a test of the low of the prior push down.
- Selling a third or fourth push-up in a bull stairs pattern for a test of the high of the prior push-up.
- Trading when the channel in a spike and channel day or the breakout in a trending trading range day reaches a measured move target and the move is weakening.

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- Buying a high 2 pullback to the moving average in a bull trend.
 - Selling a low 2 pullback to the moving average in a bear trend.
 - Buying a wedge bull flag pullback in a bull trend.
 - Selling a wedge bear flag pullback in a bear trend.
 - Buying a breakout pullback after a breakout from a bull flag in a bull trend.
 - Selling a breakout pullback after a breakout from a bear flag in a bear trend.
 - Buying a high 1 pullback in a strong bull spike in a bull trend, but not after a strong buy climax.
 - Selling a low 1 pullback in a strong bear spike in a bear trend, but not after a strong sell climax.
 - Shorting at the top of a trading range, especially if it is a second entry.
 - Buying at the bottom of a trading range, especially if it is a second entry.

Entering using limit orders requires more experience reading charts because the traders are entering a market that is going in the opposite direction to their trade. Traders should only use the limit orders to trade in the direction of the trend. For example, if a trader is thinking about using a limit order to buy at the low of the prior bar, they should only do so if the market is always in long, or they think that it is likely to immediately switch to always in long. They should never buy with the

intention of scalping the long and then shorting once the low 2 sell setup forms if they believe that the market is still always in short and is likely to have only one smaller push-up. The probability of success is simply too low when using limit orders to trade countertrend. The low probability results in a losing trader's equation and you will lose money unless you are an exceptionally profitable and experienced scalper.

Surprises in trends are usually in the direction of the trend, so when you think that the low 1 in a bear trend is weak and that the market should have one more push-up, the odds are too great that it will not. However, experienced traders can reliably use limit or market orders with these potential best trade setups:

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- Buying a bull spike in a strong bull breakout at the market or on a limit order at or below the low of the prior bar (entering in spikes requires a wider stop and the spike happens quickly; this combination is difficult for many traders).
 - Selling a bear spike in a strong bear breakout at the market or on a limit order at or above the high of the prior bar (entering in spikes requires a wider stop and the spike happens quickly; this combination is difficult for many traders).
 - Buying at or below a low 1-2 weak signal bar on a limit order in a possible new bull trend after a strong reversal up or at the bottom of a trading range.
 - Shorting at or above a high 1-2 weak signal bar on a limit order in a possible new bear trend after a strong reversal down or at the top of a trading range.
 - Buying at or below the prior bar on a limit order in a quiet bull flag at the moving average.
 - Shorting at or above the prior bar on a limit order in a quiet bear flag at the moving average.
 - Buying below a bull bar that breaks above a bull flag, anticipating a breakout pullback.
 - Selling above a bear bar that breaks below a bear flag, anticipating a breakout pullback.
 - When trying for a swing in a bull trend, buying or buying more on a breakout test, which is an attempt to run breakeven stops from an earlier long entry.

- When trying for a swing in a bear trend, selling or selling more on a breakout test, which is an attempt to hit breakeven stops from an earlier short entry.
- Buying a pullback in a strong bull trend at a fixed number of ticks down equal to or slightly less than the average prior pullbacks.
- Selling a pullback in a strong bear trend at a fixed number of ticks up equal to or slightly less than the average prior pullbacks.
- When a bear trend is about to break into a bull trend and needs one more bull trend bar to confirm the always in reversal, and the breakout does not look strong, sell the close of the bull breakout bar, expecting the follow-through bar not to confirm the always in flip and the bear trend to resume.

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- When a bull trend is about to break into a bear trend and needs one more bear trend bar to confirm the always in reversal, and the breakout does not look strong, buy the close of the bear breakout bar, expecting the follow-through bar not to confirm the always in flip and the bull trend to resume.

Top 10 Rules for Successful Trading

Here are some guidelines that beginners should consider following until they are consistently profitable (at that point, they can expand their repertoire):

1. Take a trade only where you are going for a reward that is at least as large as your risk. When starting out, focus on trades where the reward is at least twice as large as the risk.
2. Take trades only if you think they probably will work. Don't even worry about how far the move might go. You have to simply ask yourself if the setup looks good. If so, you should assume that the probability is at least 60%. With the potential reward at least as large as the risk, this creates a positive trader's equation.
3. Enter only on stops.
4. Always have a protective stop in the market, because belief and hope will not protect against a

premise that is failing.

5. Have a profit-taking limit order in the market so that you will not get greedy and watch your profit disappear as you hope for more.
6. Buy only above bull bars and short below bear bars.
7. Trade only a small position size. If you think that you can trade 300 shares, you should trade only 100 shares so that you are in “I don’t care” mode. This will allow you to be more objective and less easily swayed by emotions.
8. Look for only 3-5 reasonable trades a day. If in doubt, stay out.
9. Look for simple strategies. If something is not clear, wait.

10. The best choices for a trader starting out are trends that develop in the opening range, strong trend reversals, and pullbacks in strong trends.

How Much Do You Buy or Sell?

Many traders try as much as possible to avoid the reality of this question. This question clearly explains money management. It's quite critical to the success of a trader. Let's explain the concept better using an example:

Hypothetically, you've got a certain amount of cash, at this point, you get to ask yourself the question of "how much is best to trade?" being more practical, let's say you've \$10,000, how much of this total amount would you want to trade? Will you be smart to ask yourself this question or you will just decide to trade all you've? If you decide to trade all you've, what if you lose all \$10,000?

Well, making the best decisions in this kind of situation means investing only about 2% of your capital. 2% of \$10,000 means investing only \$200. At the point of making this decision, you might as well say to yourself "What is the deal? I have got \$10,000 why invest \$200? Isn't that too small?" Well, that's not the point.

Conclusion

Technical analysis (TA) is a method of trading based on patterns and trends that emerges from charting stocks and other assets over time. These patterns form trends which are then used to make predictions about stock prices.

Technical traders do this through what are called indicators. An indicator is a mathematical calculation based on price and volume which generates a signal which can be used to determine trends. Indicators are by no means a modern invention but the use of indicators such as the MACD is relatively new to mainstream traders, having been developed in the 1960s.

This method of trading has become increasingly popular as computers have become more advanced and more people have started using them to look at charts and make decisions about when they should buy/sell assets. This is known as algorithmic trading where traders program computer algorithms to automatically make trades for them based on conditions they have specified in their algorithm. Computer trading is also known as high-frequency trading where traders use computer algorithms to buy and sell assets within nanoseconds, separated by fractions of a second.

Traders do this by using indicators on their charts in order to decide when things are likely to change or whether there will be a big change in direction at all. These changes in direction can either be stops or targets and these are decided based on how well the traders' indicators are performing. Traders can then use the information they have gained from this method to make decisions about what to buy and how to sell, if at all.

The idea behind technical analysis is that the stronger the asset's performance is over a longer time period, the more likely it is to continue that movement for a little while longer and vice versa. So, if an asset has been going up for a long time, traders will want to take advantage of what they think

will happen next and vice versa. Over time, this method can make profits from the stock market if things pan out as traders expect them to.

However, just because there is a strong uptrend in place doesn't mean that this uptrend will end tomorrow. Traders can take advantage of this by buying an asset and selling it when its price reaches their target or stop loss. Some traders may even wait until the price goes higher, taking profit along the way. Technical analysis does not guarantee that you will make a profit, though, so traders need to be careful when they use it and must expect to need to take losses if things do not go as planned.

Technical analysis is also known as charting or technical trading because traders rely on charts of assets in order to make their decisions. These charts track changes in prices over time and can give valuable information about how well indicators are performing which can be used to decide on targets or stops.

Technical analysis can also be used to help traders plan for future events in the market such as news or a company announcing its earnings. Technical traders would then try to read through the news and understand how it might affect the asset they are trading. This could then be added to their charts and used as a reference for what is likely to happen next. As a result of this, some traders will chart up-to-date news events and use them

as indicators by which they will make their decisions about what to buy or sell.

Technical analysis is not always successful, however. If a trader's analysis is wrong or the asset moves in an unexpected way, the price may move up and down before moving back in the direction of the trader's analysis. This can either cause a loss or make a trader miss out on profits that they could get if they weren't trading based on their analysis.

There are also many different indicators and ways to use technical analysis which can cause traders problems such as getting too caught up in the analysis rather than trading. Trading is important because you need to move fast when prices are changing, but you also need to have a plan first so

you know what your next move will be when an opportunity arises. There are so many different aspects to trading that you need to have a plan for what your next move will be before you start. Otherwise, it can be hard to make good decisions.

Glossary

AI/machine learning: Artificial intelligence or machine learning is giving a computer the ability to reprogram itself in the light of the information it has handled—basically, to learn. Computers can be taught to “recognize” chart patterns and will then refine their definition of the pattern by the results.

Algorithm: An algorithm is a mathematical process, or set of rules to be followed in a calculation. Algorithmic trading uses a computer program that places trades according to the rules that have been set.

AMA: Adaptive moving average: Different types include KAMA, JAMA, and HMA, after their inventors Kaufman, Jurik, and Hull. For technical analysis, they work in a similar way to the normal moving averages and EMA.

Ascending Triangle: A formation where the highs and lows form a triangle with the point on the top edge. The price is expected to break out in an upwards direction.

ATR: Average true range: Average trading range, including the averaging out of all gaps.

Backtesting: Running a test of a chart pattern against historical data to see how often a given trade rule would have been successful.

Bar: Shows the open, high, low, and closing price (OHLC) of a stock for a given period in the form of a bar (high/low) with 2 “tabs” showing the open and close.

Bear: Someone who thinks the market or a stock will go down. They are “bearish,” that word also describes a chart formation that is likely to lead to a downwards price move.

Behavioral economics: Looking at economics as the sum total of individual actions, and bringing psychology to bear on why participants in an economic market behave the way they do.

Bollinger bands: Bands that are placed one standard deviation above and below the moving average. They're useful because they show the volatility of the price—how much it's likely to swing.

Bond: A kind of security that pays a “coupon” at a given rate of interest, issued by a government or corporation to raise debt funding.

Breakaway gap: A movement through support or resistance which is so strong that the stock “gaps” through the line—that is, opening a trading session above resistance, or below support, leaving a “gap” in the price chart.

Breakout: When a price breaks through a support or resistance line, or out of a chart pattern.

Bull: Someone who thinks the stock market or a particular stock will go up. “Bullish” might describe such a person or a chart formation that suggests the price will go up.

Bull/bear ratio: A market indicator published each week that shows the number of advisors who are bullish against the number who are bearish.

Candlestick: An alternative to the bar, the candlestick draws a box between the opening and closing prices, with a “wick” or “shadow” to show the high and low of the trading session. It is colored white/green if the price went up, black/red if the price went down.

CBOE: Chicago Board Options Exchange, the largest US options exchange.

Change momentum indicator: A technical indicator that uses momentum to identify relative strength or weakness in a market. Similar to the Stochastic indicator.

Channel: The band within which a stock is trading. In a typical chart, if the stock is trading in a horizontal range, you can draw one line joining all the “tops” and one line joining all the “bottoms,” and this defines the channel.

Chart: A graphical representation of a stock's price movement.

Close: The closing price of a trading session.

Confirmation bias: When we believe more strongly things that happen to coincide with our existing beliefs.

Congestion: When a stock trades within a very narrow range of prices, showing that buyers and sellers are evenly balanced. It often happens after a major move in the share price.

Consolidation: A stock or security that is neither continuing nor reversing a larger price trend.

Continuation: When a chart pattern shows the share price should break out in the same direction as the existing trend.

Correction: When a share price falls because it has become overbought, but the overall uptrend is not broken.

Crossover line: when the price and an indicator (e.g., a moving average) or 2 indicators (e.g., 2 moving averages) cross each other.

Dead cat bounce: A sharp bounce within a major downtrend. Often, a market crash has a dead cat bounce that can look like recovery but very quickly fails.

Death cross: When the 50-day moving average crosses below the 200-day MA. A bearish indicator.

Derivative: Any security whose price depends on that of another security (e.g., an option, whose price depends on the underlying share).

Descending triangle: A formation where the highs and lows form a triangle with the point at the bottom. The price is expected to break out in a downwards direction.

Dividend: Some shares make a cash payment to their shareholders every quarter (usual in the USA), half-year (in the UK), or sometimes, monthly. This is paid out of the company's profits and is called the dividend. Calculate the dividend as a percentage of the share price and you have the dividend yield, which you can compare with the bank interest rate—it's the money you will be paid on your investment. But of course, in the case of shares, the price can also move up or down,

whereas the cash in your bank account, if you put \$100 in, stays \$100—it's not going to turn into \$50 or \$125.

Donchian rule: Buying when a stock reaches a 4-week high and selling when it reaches a 4-week low. The Donchian rule relies on momentum—the idea that if the stock has reached a 4-week high it has established an uptrend that ought to continue.

Double bottom: A chart formation where the stock in a downtrend hits a support line twice and bounces off it both times; a breakout into an uptrend is likely.

Elliott Wave: The Elliott Wave principle attempts to identify long-term “waves” based on investor behavior, sometimes using the Fibonacci series.

EMA: Exponential moving average. This attempts to refine the ordinary moving average by giving more weight to more recent price moves.

ETF: An exchange-traded fund, also known as a “tracker,” is a fund that replicates an index like the S&P500, Russell 1000, or Dow Jones Industrial Average. It's bought and sold like a normal stock, through a broker, and the big ETFs have tight spreads and low costs so they're a good way to trade the market.

Exhaustion gap: When a stock that has been rising fast gaps down. This shows that the price is no longer being driven by buyers—they are “exhausted.”

False breakout/fakeout: When a share price crosses a resistance or support line, but then after a very small

movement reverses the move. It's easy to fall into a trap here so make sure your stop- losses are good.

False signal: When a chart appears to be giving a signal, but in fact, it's just “noise.” You can help avoid false signals by checking the signal with a second indicator.

Flag: A short-term rectangular trading channel running in the opposite direction to the main trend. You are looking for a signal when the price breaks out of the flag.

FTSE: The FTSE group runs a number of indexes, of which the best known is the FTSE 100, the UK stock market's biggest 100 stocks.

Fundamentals: The business realities behind the share, such as its earnings, assets, brand names, and operations.

Gap: When a share opens a trading session above or below the previous session's closing price and leaves a gap visible on the chart. This can be a strong signal.

Golden cross: 50-day moving average crossing above the 200-day MA. This is a bullish signal.

Guerrilla trading: Very short-term trading which aims for a low profit on each trade but making multiple trades within a trading session, often closing trades within just a few minutes.

Head and shoulders: A chart formation that forms 3 “peaks” with the largest in the middle. It is generally completed by a breakdown from the third peak, signaled by the price closing below the “neckline” joining the lowest prices in the series.

Heiken Ashi bar: Heiken Ashi takes candlesticks and uses an averaging formula to attempt to remove the “noise” from the chart, minimizing false signals.

HFT: High-frequency trading, using computerized orders based on algorithms; can trade many times a second.

High: The highest price reached by a share during any particular formation. Also, 52-week highs, which are reported on financial news pages and websites.

Ichimoku indicators: This is a relatively new technique we have not covered, which attempts to forecast potential price ranges as “clouds.” It's based on candlestick charting but tries to extrapolate it forwards.

Index: A “bundle” of shares created by mathematical means (e.g., the S&P 500). The index reflects the aggregate performance of all the component shares.

Indicator: An indicator is based on an arithmetic manipulation of the raw price data. Examples would be a moving average, RSI, Stochastic, or Price by Volume.

Island reversal: A candlestick pattern in which the stock price creates an “island” top or bottom separated by gaps from the “mainland” trends.

Kondratieff wave: Kondratieff waves are very, very long-term waves. Personally, I am not willing to wait 40-60 years to see if my trades work out. Many academic economists don't believe in these waves, either.

Limit order: An order where you state a limit above which you are unwilling to buy, or below which you are unwilling to sell, a stock.

Linear regression line: The “line of best fit” allows all data points to be equally distributed around the line.

Liquidity: The ease with which a given security can be traded. More generally, the volume of trading in the stock market.

Long: To “go long” is to buy and hold shares.

Low: The low point in any given price pattern or formation. 52-week lows can be informative and are found on financial websites alongside other basic price information.

MACD: Moving average convergence divergence indicator. It shows the relationship between 2 moving

averages and can show changes in the momentum of the stock price.

Margin: If you trade on margin, you are borrowing money from your broker to buy the stock. I do not advise you do this. It is an easy way to ruin yourself.

Market indicators: These are used to forecast trends for the market as a whole, such as the market breadth index (the ratio between stocks which closed up, and stocks that closed down).

Market order: An order to buy stock “at-the-market,” that is, at the best price your broker can get.

Market timing: Trying to buy the market at the bottom and sell at the top. An impossible dream. Good traders are happy with getting 80% of the price action.

Maximum adverse excursion: The largest loss a single trade can suffer while it is open.

MBar or momentum bar (constant range bar): These charts, unlike conventional share price charts, do not show time. A bar is created for each move of a given amount, e.g., 10 cents. Some traders like these because they cut out a lot of “noise.”

Mean reversion: The statistical likelihood that eventually extreme values will revert to the mean.

Momentum: The rate of change in prices.

NASDAQ: The second US stock exchange. It is all-electronic trading and has a higher percentage of tech stocks than the New York Stock Exchange.

Noise to signal: “Signal” is what we are looking for, something that tells us when a stock is going to go up or down. “Noise” is all the other stuff. It's like listening to old vinyl—the music is signal, the crackle and scratches are “noise.”

NYSE: The New York Stock Exchange.

OBV: On balance volume, an indicator that shows up volume and down volume, giving a feel for how much of

the trading volume relates to purchasers/bullish action and how much to sellers/bearish action.

Open: The share price at the opening of a trading session.

Option: A derivative that gives you the right to buy a share at a given price before a given date. It could simply be a private agreement, but most options are standardized and traded. Options are potentially useful because (1) they give you leverage, going up or down more than the share price, and (2) put options enable you to trade downtrends and breakdowns.

Oscillator: An indicator that shows values oscillating in a band between 2 extreme values, e.g., price acceleration between 0-100. RSI, Chaikin, and ROC are all types of oscillators.

Overbought/oversold: When a stock is “overbought,” all the interested buyers have already bought it, and it is exposed if any of them decide to sell. Indicators such as RSI and OBV attempt to show when stocks are overbought or oversold.

Pennant: A short-term triangular formation within a defined up or downtrend. It is a continuation pattern, meaning that you'd expect to see the price break out in the same direction as the main trend.

Point-and-figure chart: These charts don't take account of the passage of time but create columns of price rises of a certain magnitude, reversing direction when the price direction changes. So, if a stock price went up to \$10 every day for a week, and you had a \$10 unit, you would end up with a column of 5 X's (or O's if the price were to go down). They are not much used these days, but the MBar is a more modern version of the same idea.

Put/call ratio: The proportion between put and call options purchased on a given day. It's a good way to measure whether the market is bearish (more puts) or bullish (more calls).

Pyramiding: Involves adding to a winning position as the price moves in the desired direction. It can be a good way to make more profit from a really strong breakout, but the stop-loss for the whole position needs to be

reassessed to take account of the higher average purchase price.

Quant: Basically any individual in the investment community who bases their work on mathematics rather than gut feel, fundamentals, philosophy, or hype.

Range contraction: When the range within which the share price varies becomes smaller.

Range expansion: When the range within which the share price varies becomes larger.

Range trading: Identifying the range within which the share price trades, and aiming to buy towards the bottom of the range and sell towards the top of it, again, and again, and again.

Resistance: The concept that a stock will have a certain price level that it has touched several times but never exceeded, and that this forms a “resistance” to a move upwards. Drawing a resistance line is often a useful way of showing this.

Retracement: The amount that a stock “gives back” from a rise (or fall) in the share price before the uptrend (or downtrend) resumes.

Reversal: A change in the overall share price trend.

Risk appetite/risk aversion: A trader's desire to take on more risk, or desire to avoid risk. Risk is a spectrum, and not all traders have the same appetite for risk.

Risk reward ratio: The ratio between the risk you run and the reward you expect. For an individual trade, the ratio between the profit target and the stop-loss.

RSI: Relative strength index. An oscillator that displays bullish and bearish price momentum.

Runaway gap: A gap in the direction of the trend, usually associated with high volume. A bullish indicator.

Security: Any form of negotiable instrument representing financial value (e.g., a stock, bond, or option).

Share: A security entitling the holder to a share in the earnings and assets of a business.

Short: To “go short” is to sell shares you do not own. You will consequently profit if the share price goes down, as you can “cover your short” by buying the shares at a lower price.

Slippage: When your order is executed for a worse price than you expected.

SMA: Simple moving average. The average of the share’s price over the last X time periods.

Spike: A sudden and large move in the share price.

Spread: When you buy stocks you pay a higher price than you'd get if you sold—the difference is the “spread” and it's how market makers and specialists make their money. Spread is one of the costs you need to allow for as a trader.

Standard deviation: A measure of how far values differ from the mean. For instance, a class of 10- year-olds probably has a low standard deviation in height; they will all be roughly as tall as each other. SD is one way to measure the volatility of a share price.

Standard error channel: Parallel lines drawn equidistant from the linear regression trend line to form a channel.

Stochastic oscillator: An indicator that shows momentum based on the price history of the asset.

Stop-limit order: An order which specifies a price at which the order becomes valid, and a price limit after which it is no longer valid, e.g., "Sell 100 IBM if the stock price falls below 90 but not if it goes below 95." It's a good way of entering a breakout or breakdown trade.

Stop-loss: The price at which you will close a trade if it goes in the wrong direction. You should always set a stop-loss at the same time as you make your original trade.

Support: A line which the share price repeatedly hits and then bounces. If a stock falls, it will usually stop at the support line, either temporarily, or before returning to higher levels. If a stock falls through the support line, it may well fall all the way to the next support line.

Swing trader: Traders are aiming to make gains by trading a stock and holding it for just a few days. They almost always use technical analysis.

Technical analysis: Reading patterns in the movement of the share price to ascertain the probability of the share price behaving in a particular way in the future.

Tick bars: Tick bars show price movement only if there has been a minimum number of trades.

Tracker: A fund that represents an index that is automatically created and traded on a stockexchange in the same way as a share.

Trailing stop: A stop-loss that is increased as the price of the share goes up so that you can't lose all your gains.

Trend: The general movement in a share price, either upwards, downwards, or sideways.

Trendline: A line that can be drawn to show the trend.

Triple top: Where the share price forms 3 peaks all hitting the same resistance level. The third time, it is likely to break downwards.

VIX index: An index that measures share price volatility.

Volatility: The amount of change in a share price. A share price that tends to move 1% a day is much less volatile than one that swings by 5-10% some days.

Volume: The amount of shares traded on a single day.

Wedge: A chart formation in which the share price forms a wedge that is pointing up or down in the opposite direction to the trend. The price should break out in the direction of the trend.

Whipsaw: A sudden change in the direction of the share price. Sometimes a whipsaw happens before a real breakout, which can be deceptive.

WMA: Weighted moving average.



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**Create Automatic
Income For
Life
Immediately
!**