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**TRADING TOOLS & STRATEGIES THAT
GENERATE CONSISTENT PROFITS**

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Chapter I
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Monkey business: The stock Market story.

Once upon a time, a wealthy businessman arrived in a small village. He told the people that he would buy monkeys for \$100 each. After all, there were hundreds of monkeys in a neighboring forest, so the residents were thrilled. They captured the monkeys and delivered them to the businessman.

He purchased hundreds of monkeys and paid the villagers \$100 for each one they gave him. The villagers started getting monkeys from the forest and selling them to businessmen to make a living. Soon, the forest began to run out of easy-to-catch monkeys.

Sensing this, the businessman offers \$200 for each monkey. The villagers were delighted. They again went to the forest, set up traps, captured the monkeys, and gave them to the businessman.

After a few days, the wealthy man declared he would pay \$300 per monkey. The villagers went deep into the forest and started climbing trees and risking their lives to capture monkeys and deliver them to the businessman who had purchased them. In the forest, there were no more monkeys!

The businessman said one day that he wanted to acquire additional monkeys, and this time he was ready to pay \$800 for each monkey. The people couldn't believe what they were hearing. They were eagerly attempting to catch more monkeys .

Meanwhile, the wealthy man said he needed to return to the city for some business and that his manager would handle it on his behalf until he returned. The villagers were disappointed once he left. They could make quick money by selling monkeys, but the forest was empty of monkeys. This was when the wealthy man's manager intervened. He gave the villagers an offer they couldn't refuse.

He showed the villagers all the monkeys that the wealthy man had caged. He assured the residents that he would sell the monkeys for \$400 each. "When the rich man returns, I will tell him that the monkeys escaped and

you can sell them to him for 800 dollars each," the manager said. The residents were again thrilled. They calculated the math. You can buy it for \$400 and sell it for \$800. They'd just discovered the most efficient way to double their money. The people gathered all of their funds and even took out a loan.

There were enormous lines, and the manager sold out practically all the monkeys within a few hours. Unfortunately, their joy was short-lived since the manager vanished the next day and the wealthy man never returned.

Many villagers kept the monkeys, hoping the wealthy man would return. However, they quickly lost hope and released the monkeys back into the forest because feeding and caring for the noisy monkeys had become very difficult.

This story is the perfect way to explain how the financial markets work.

The wealthy businessman represents the key players in the capital markets, like corporate financial institutions, investment banks, and foreign institutional investors. On the other hand, the villagers represent the new and ordinary traders trading in the market .

By buying or selling a huge amount of stocks in a short period of time, the big players can change the prices of stocks in a way that fools smaller traders. When regular traders see this, they think it's a chance to make money and buy or sell financial assets to make a profit.

Once they're all in, these smart traders go in the opposite direction, taking all the capital money from ordinary traders. Once the regular traders realize it, it will be too late. So they end up losing all their money.

Is there any way to stop this from happening?

The quick answer is to do a thorough analysis before entering every trade. This is where technical analysis helps.

Let's call it Plan A.

By doing this, you can come up with a logical certainty about how the price will move and know when it is safe to enter and leave each trade. This will protect your trading capital and help you make money.

But what if the technical analysis fails?

Even if technical analysis fails, investors can still protect their trading capital.

Let's call it Plan B, which is trade discipline.

The upcoming chapters will examine and explain these concepts .

Note : I strongly advise readers not to miss **Chapter 5** , " **Trade discipline** ." It's the most important chapter because it shows the essence and secrets of trading, ultimately determining a trader's success.

Did you Know?

In 1954, Armen Alchian, an economist, was able to figure out the secret fuel for the newly built hydrogen bomb by looking at chemical suppliers' stock market share prices. Scientists used Lithium as a source of energy, according to Armen Alchian. During the experiments, he noticed that the stock price of Lithium Corp. grew considerably. This company saw a 461% return over the project's first year!

Which category are you in?



- It is said that about **90%** of people doing intraday trading end up with losses.
- **4%** neither make a loss nor any profit.
- Only **6%** of traders become successful.

They are known as " **professional** " or " **intelligent** " traders .

Why do 90% of people who trade in the stock market fail?

They fail because:

- They don't research the stock, currency, or commodity they are trading.
- They trade without having any plan or trading strategy.
- They rely too much on other people's recommendations.
- They don't have any trade discipline.

Remember, in financial markets, the loss of one person is another person's profit.

There is a 90-90-90 rule in the stock market industry.

The rule states that

"90% of traders lose 90% of their capital within the first 90 days of account opening!"

The 6% of smart and intelligent traders enjoy the losses made by the other 90% of total traders. Please note that the 6% traders become large numbers when considering the total number of traders.

Many people enter into trades just because everyone else around them is doing it, and they most likely end up in losses. If you want to become one of the most successful traders in the stock market, you need to do the opposite of what the other 90% of ordinary traders do.

Yes, you heard it right!

Swim against the current, which is the ultimate secret for successful trading. One can achieve great success in trading with the right tools and strategies. That is the purpose of this book.

"To help all traders make consistent, profitable trades with ease to achieve financial independence."

Technical Analysis

Technical analysis examines price trends and chart patterns to evaluate investments and identify trading opportunities. In technical analysis, past trading activity and price changes can be good indicators of what the security's price will do in the future.

Trend :

In technical analysis, a trend is a sustainable direction of price movement. Trends describe the general direction of a market or an asset's price. Let us learn a few basic terminologies for better understanding:

Trend line :

A straight line drawn on a chart connecting the price's highs or lows shows the price movement's general direction.

Higher high :

When a price makes a new high by crossing above the previous high level, such a development (surge) is often defined as a "higher high" price movement.

Higher low :

When a price makes a new low more elevated than the previous low, it is termed a "higher low."

- **Lower High:**

When a price goes down and makes a new high below the previous high, it is called a lower high.

- **Lower low :**

When a price goes down and makes a new low below the previous low, the trend is described as a lower low.

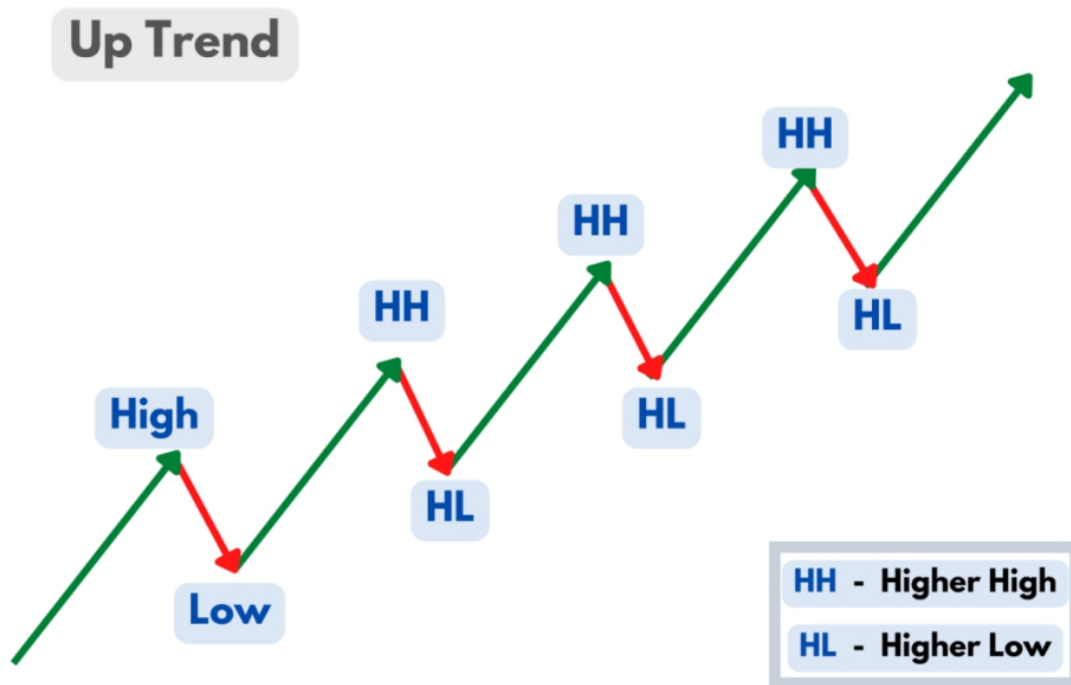
- **Breakout :**

In technical analysis, a breakout occurs when the price moves above a resistance level or downward below a support level. A breakout indicates a potential trend in the breakout direction.

Did You Know?

In the Stock Market, there is a myth about October. There's even a phenomenon known as The October Effect. According to popular belief, the stock market falls more in October than in other months. In October, there were two major crashes.

Both the 1929 Great Crash and the 1987 Crash occurred in October. However, according to research, the stock market has more significant fluctuations in October than in any other month. As a result, you could expect a lot more volatility in October.



Uptrend: An uptrend is the price movement of a financial asset when the overall direction is upward. That means it goes up and down practically, with higher highs and higher lows over some time.

Looking up the chart, the continuous movement of prices scales new highs, breaking the previous highs. This is the essential requirement for buying a Stock or commodity. A stock can trend upwards, downwards, or sideways for extended periods (days, weeks, or months).

How long does it take for a stock to qualify as being in an uptrend?

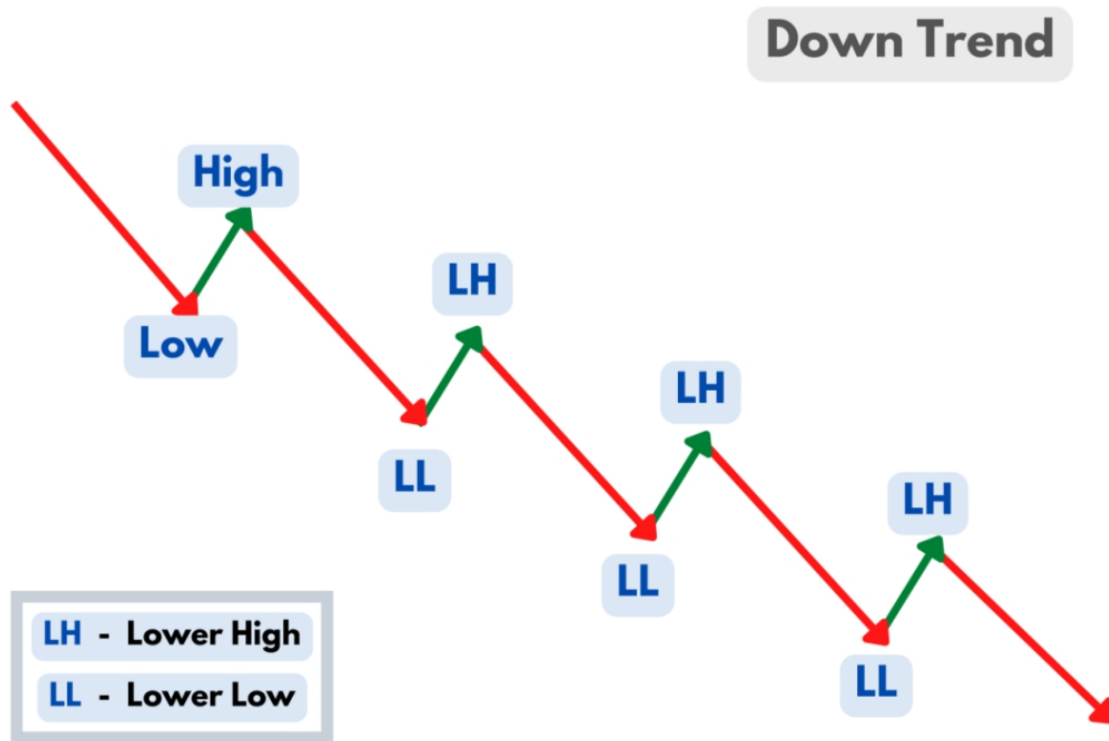
Technically speaking, as soon as you see three consecutively higher high prices with higher lows in between those highs, you can say that you have set up an upward trending price pattern.



The above chart shows the price chart of Crude oil futures.

The price is moving in the upward direction making new highs.

- The price took a U-turn from the downtrend to uptrend from point A (Low) to Point B(High).
- The price moved upwards, creating new Higher highs (HH) and recent Higher Lows (HL).
- The uptrend is confirmed when the price made three consecutive Higher highs and three higher lows.
- This uptrend will change direction to a downtrend on forming three consecutive Lower highs and lower lows.



Downtrend : This is just the opposite of an Uptrend. Here, the overall direction is downward. The price moves downward continuously, with lower highs and lower lows. A downward trend is identified when there are three consecutive lower lows with lower highs between those lows, which means the sell mode is ON.

Rule of thumb: Most of the time, price breakouts happen in the trend direction.



The above chart shows the price chart of Gold/USD.

The price is moving in a downward direction, making new lower lows.

- From point B onward, the price direction changed from an uptrend to a downtrend.
- The price moved downward, creating new Lower highs (LH) and Lower Lows (LL).
- The downtrend was confirmed when the price made three Lower Lows and three lower Highs.
- This downtrend will change direction to an uptrend after forming three consecutive Higher Lows and Higher Highs.

Trend Line

A trend line is a straight line drawn on a chart connecting the highs or lows of the price, which shows the general direction of the price movement.

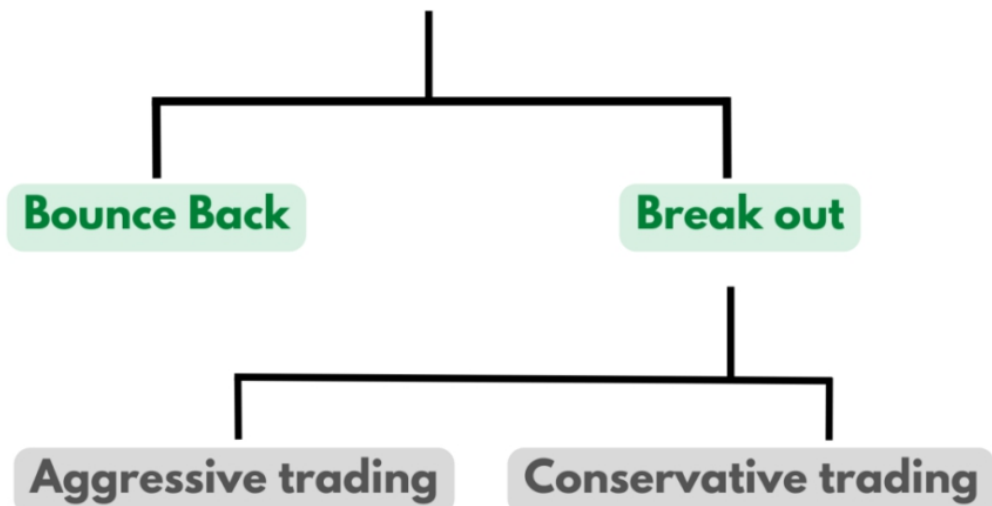
A trendline acts as diagonal support or resistance. A trendline is formed by connecting the first and second lows or highs. The price usually breaks out of a trend line on the fourth or fifth touch.



The above figure shows EURO/USD 1-hour price chart.

- Here, the trend line is formed by connecting the first and second lows.
- The trend line is validated on the third and fourth touches, and the price breaks out of the trend line on the fifth touch.

Support and resistance

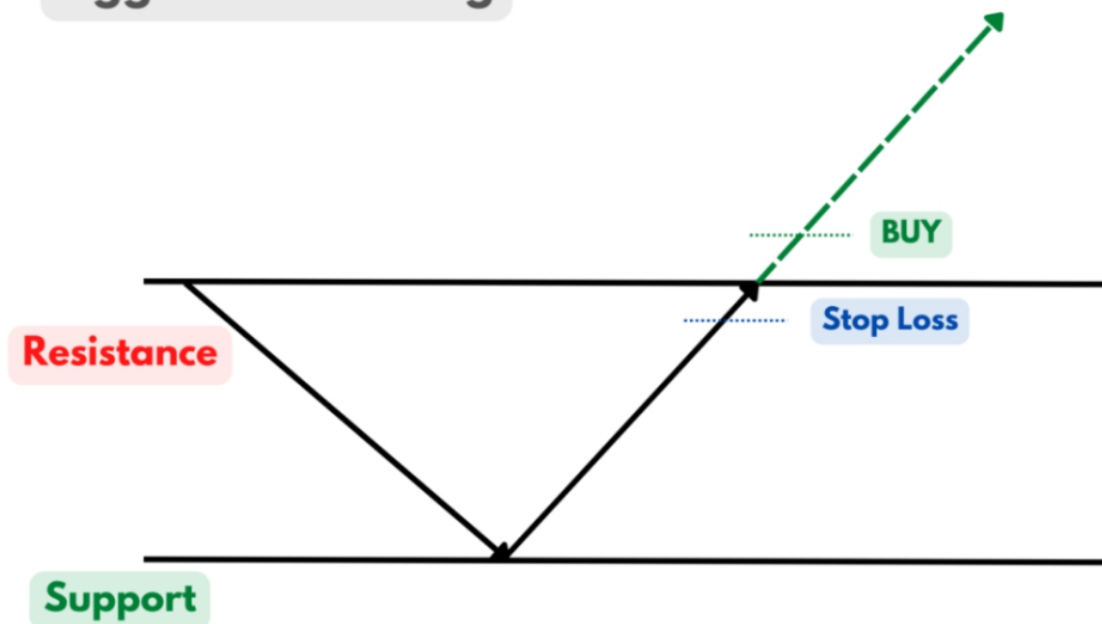


The price movement of an asset usually happens between a support and a resistance. The price hit the support and resistance lines repeatedly and bounced back between the levels. After bouncing back for some time, the price breaks out either from the support or the resistance level, which creates an opportunity to enter a trade.

There are two ways to enter a trade when a breakout happens:

- 1. Aggressive trading.**
- 2. Conservative trading.**

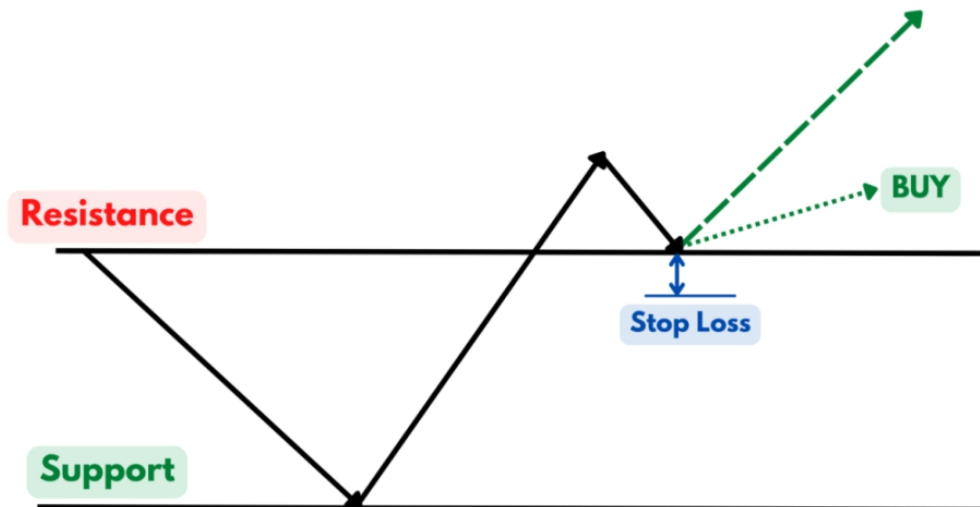
Aggressive trading



Aggressive trading is a strategy used by retail traders and individual investors to generate quick returns. Aggressive trading refers to quickly opening and closing positions, with rapid entry and exit in different market scenarios. Typically, traders hold their positions for only a few hours or days before exiting the positions to capture small gains (and avoid losses).

- **Advantages** :
Bigger profits: If the trading decision is correct, it can result in more significant gains because of a sudden price change.
- **Disadvantages** :
This trading method is a bit risky because of the quick buys and sells that happen at critical points of price movement. If the decision is wrong, it can make huge losses.

Conservative trading



The goal of conservative trading is to preserve one's trading capital with the least amount of risk. So, traders who use traditional trading strategies use both fundamental and technical analysis to make good trade decisions. When there is a price breakout, they wait for confirmation before entering the trade.

Therefore, they tend to trade over longer periods since doing that much analysis is time-consuming. Conservative trading requires patience and discipline.

- **Advantages** :
Less risky, higher success rate, and more chance of ending up in profit than aggressive trading
- **Disadvantages** :
This method is time-consuming. Less profitable than aggressive trading.

Chapter II

Pattern Trading

Most Analysed and Highly Effective Patterns

Pattern trading is an integral part of technical analysis. Successful and professional traders widely use it to trade stocks, currencies, and commodities. Over time, patterns are formed by drawing lines connecting price points, such as closing prices or highs and lows.

Price patterns often indicate a change between rising and falling trends. In every price chart, the price's continuous movement results in specific shapes identified using a set of trendlines and curves.

Each price pattern has a unique set of characteristics. By understanding these unique characteristics, one can predict in which direction the price will probably move when a price pattern formation is completed in a chart.

A price chart may consist of many different price patterns. However, specific patterns are often discussed and analyzed by experienced traders worldwide. These are called 'Signal' Patterns or 'Signs.'

The following are the sixteen most analyzed and highly effective patterns to predict the price movement of financial instruments. We will discuss in depth about different patterns, including how they look, what they mean, and how to use them effectively in real-time trades.

1) The Double Top Pattern

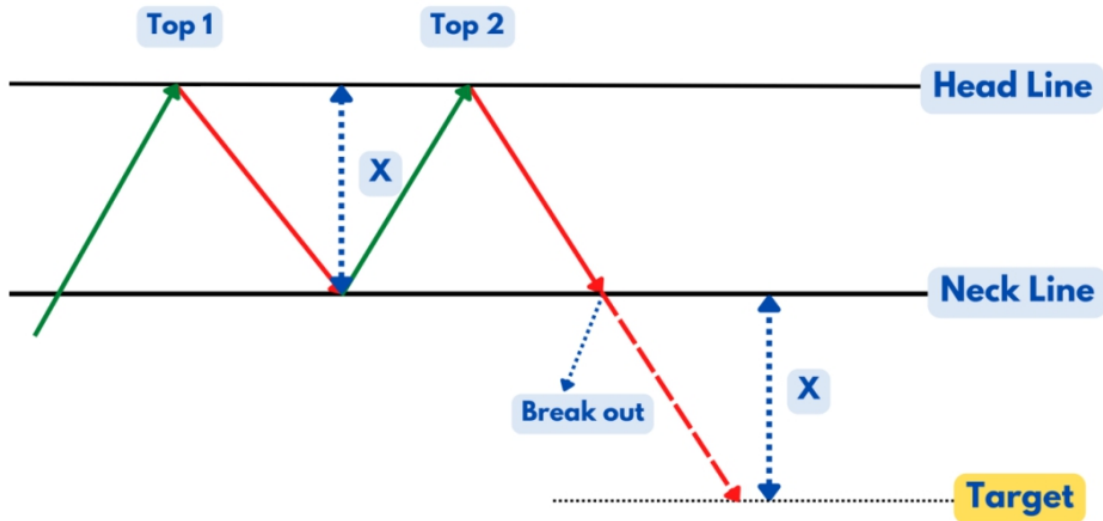


Figure 1.1

In technical analysis, a double top pattern is a reversal chart pattern when prices make two successive peaks at approximately the same price level (resistance) but fail to continue rising beyond that level. This pattern has the shape of the letter "M." The top part of "M" acts as the resistance level, and the bottom as support.

The resistance level is too strong, which won't easily allow the price to break that level and go upwards. It is a very reliable indication of bearish sentiment in an asset. This pattern indicates that upward momentum has stalled before achieving new highs.

As such, it is considered a bearish continuation pattern. The price goes down towards the support, and once it breaks the support (which happens in most cases), it will go further down.

Rule of thumb:

When a double top is formed, do the following:

1. Draw a horizontal line connecting the tops or heads of the first and second peaks (The top part of the "M" shape). It is called the Headline.
2. Draw a horizontal line through the base level from where the peaks began.
3. (The bottom part of the "M" shape). It is called the Neckline.
4. The distance (X) between the Headline and Neck Line is the new target downwards, starting from the Neckline (The total height of the "M" shape).

Important point to remember: Make sure the tops of two peaks are almost on the same level. The maximum variation for an ideal Double top is between 1% and 0.5% of the price .

Consider the following example:

The value of ABC stock is 1000 rupees.

Case 1: The first peak is 1000, and the second peak is 1005.

Then, it is a valid double top.

Case 2: First peak of 1,000 and second peak of 10,300

Then it's not a valid double top.

Tip: Traders can use indicators (mentioned in Chapter IV) to confirm before entering any position.

Double Top

AUD/USD Weekly Chart

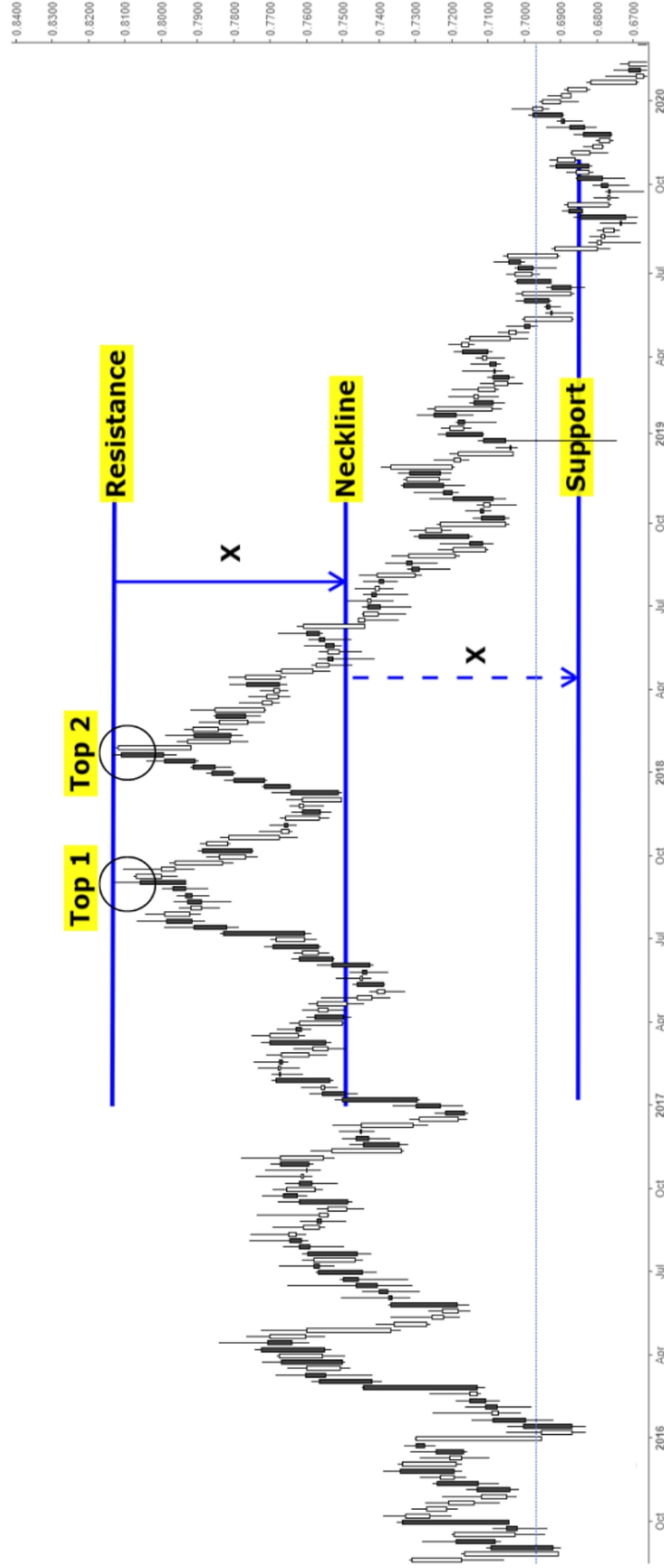


Figure 1.2

Figure 1.2 shows the weekly(Long term trade) price chart of Australian Dollar/US Dollar.

- Here the price rose, hitting the resistance line and falling back to the nearest support level, forming the first peak(Top 1).
- The price then bounced back upwards, hit the resistance line again, and fell back to the same level, forming the second peak(Top 2).
- This completes the Double top pattern setup.
- The horizontal line crossing through the bounce-back level is the Neckline.
- The price difference between the Neckline and the resistance line connecting the two tops (X) is the target for the following support.

2) The Double Bottom Pattern

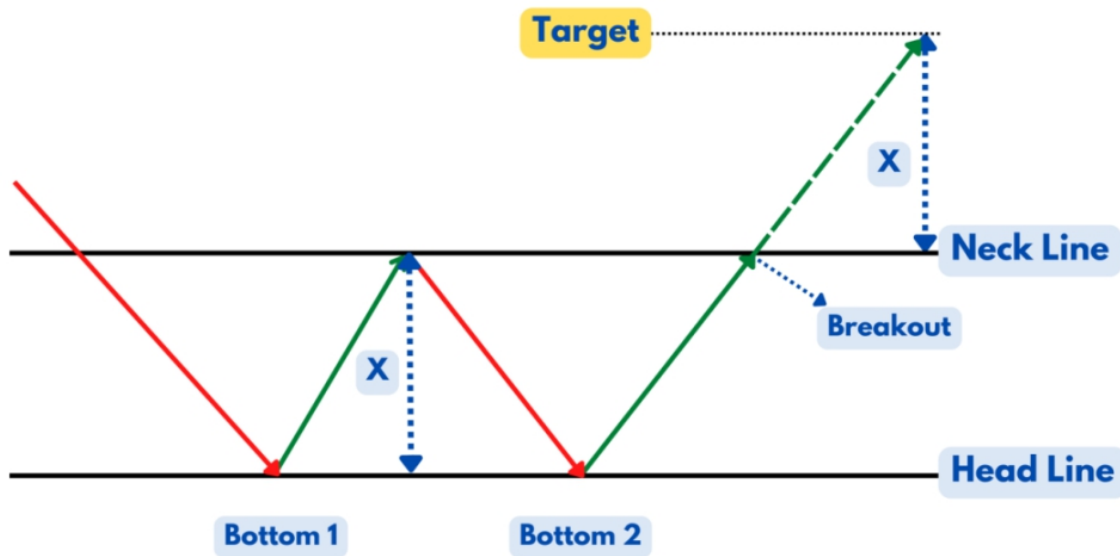


Figure 2.1

A double bottom pattern is a reversal pattern found at either end of a trend. This pattern has the shape of the letter "W." As the name suggests, the double bottom pattern has two bottom points at almost the same level.

The horizontal line connecting the two bottoms becomes a strong support level, which will cause the falling price to bounce back upwards. Usually, this bounce back causes upward solid movement towards the resistance level (the top section of "W"). A break above this price point confirms that upward trend and completes the pattern.

Professional traders trade Double top/double bottom patterns only if there is a clear indication of strength after confirmation, as a false signal can result

in losses.

Rule of thumb:

When a double bottom is formed, do the following:

1. Draw a horizontal line connecting the bottom points (inverted peaks) of the first trough and the second trough (Bottom part of the "W" shape - Headline).
2. Draw a horizontal line that passes through the top level from where the troughs started (Top part of "W" shape - Neckline).
3. The distance (X) between the Headline and Neck Line is the new target upward, starting from the Neckline. (The total height of the "W" shape)
4. Make sure the bottom points of the two peaks are almost on the same level. The maximum variation for an ideal Double bottom is between 1% and 0.5% of the price.

Double Bottom

USD/JPY Daily Chart

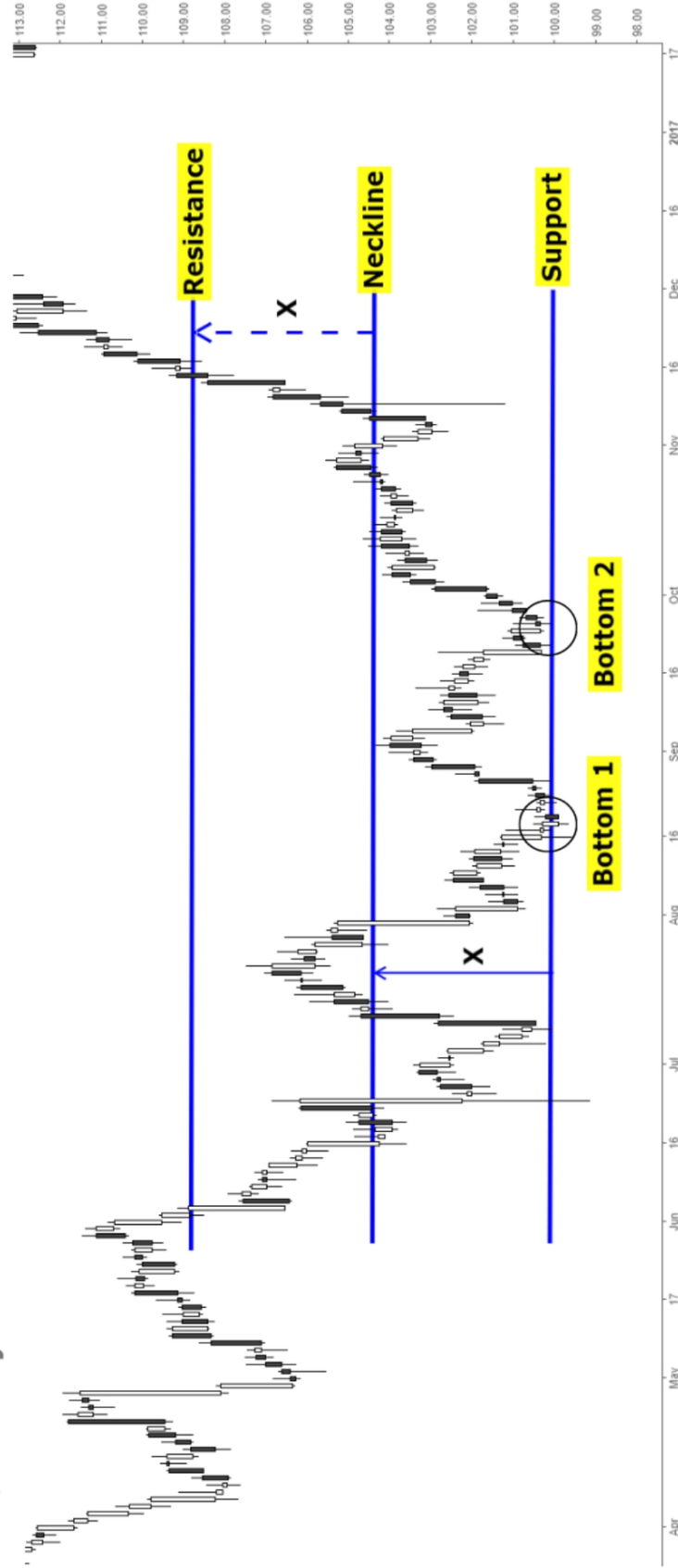


Figure 2.2

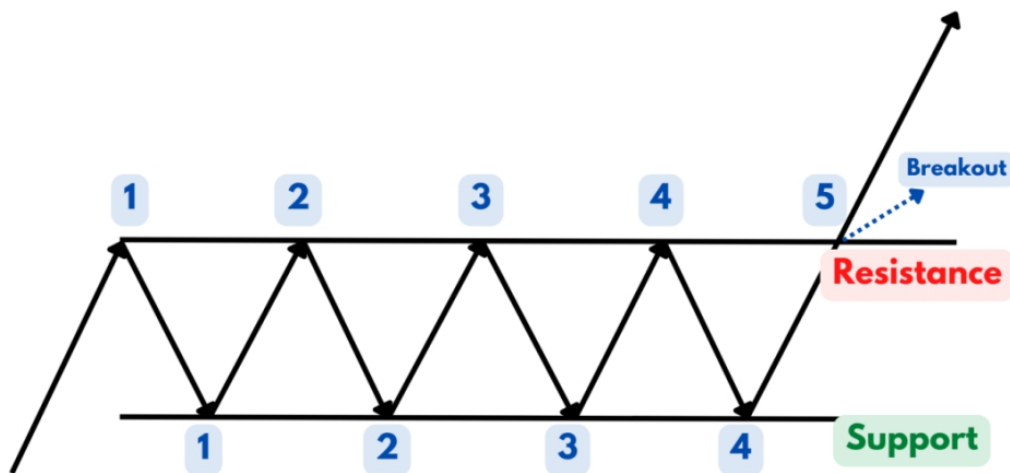
Figure 2.2 shows the daily price chart of the US Dollar/Japanese Yen.

- Here the price movement resulted in the formation of two troughs (Bottom 1 & Bottom 2) almost at the same level.
- The Neckline is X points away from the support line connecting the two bottom points.
- The target is X points from the Neckline in the upward direction.

Did You know?

In 2022, Microsoft, Apple, and Google's stock prices were worth more than the entire Chinese stock market, and Apple's was worth more than Canada's GDP.

3) The Rectangular Pattern



Figure

3.1

A rectangular channel or Box channel pattern is formed when the price of an asset moves in between two horizontal trendlines that are parallel to each other. The price moves between horizontal support and resistance for some time, indicating a period of consolidation or indecision between buyers and sellers.

Before breaking out of the channel pattern, the price will continue to touch the support and resistance lines. The direction of the trend determines which direction the rectangular pattern will break out.

Rule of thumb:

A channel is formed by three consecutive peaks/troughs.

1. All points must touch the channel trendlines at the top/bottom for every bounce back.
2. In an uptrend, the Rectangular channel usually breaks at the resistance line.
3. In a downtrend, the Rectangular channel usually breaks at the support line.
4. The price usually breaks out on the fourth or fifth touch on the support or resistance line.
5. When the price breaks out of the channel, the first target is the width of the channel. (If the channel width is 'X' points, then the price will break up or down 'X' points).
6. When a rectangular channel is formed, most traders prefer to wait for the breakout to enter the trade.
7. Aggressive traders like to trade the channels by buying near the bottom and selling or shorting near the top to take advantage of the price bouncing.

Rectangular Channel

Micron Technology Inc
Daily Chart

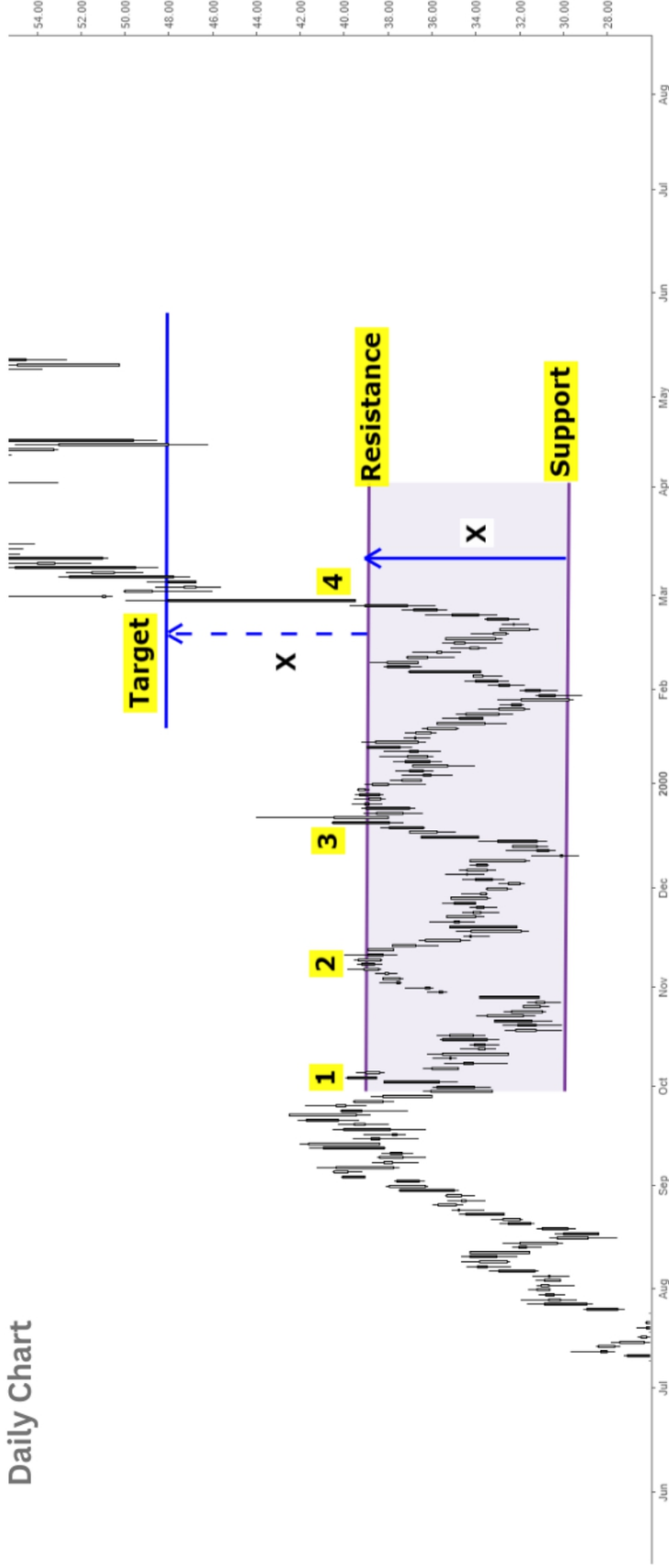


Figure 3.2

Figure 3.2 shows the daily price chart of Micron Technology Inc.

- For a while, the price moved horizontally by bouncing between points 1 and 4, making a rectangle-shaped channel.
- Here there is indecision between buyers and sellers.
- Then the buyers became intense, and the price suddenly moved upward, breaking out at point 4, resulting in a sharp price increase.
- The price moved X points upward to the first target, which is the height of the rectangular channel.

4) Ascending Channel Pattern

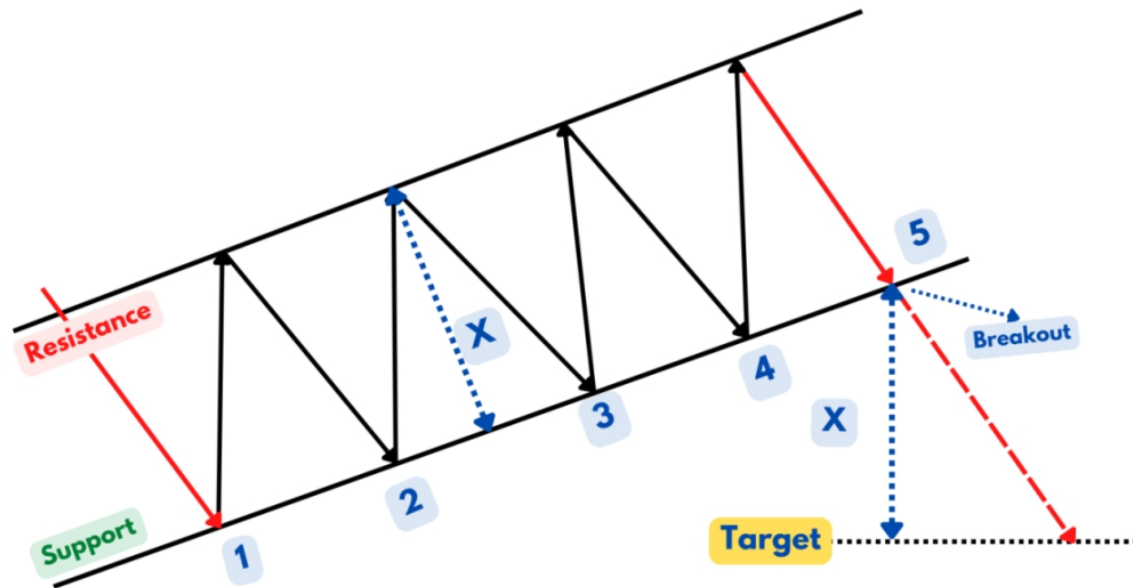


Figure 4.1

An ascending channel is the price action movement between two upward-sloping parallel lines. This pattern often appears in a downtrend. The line on top connects the higher highs, and the bottom line connects the lower lows of the asset price. The price inside the channel usually bounces between its support and resistance lines until it breaks out of the channel .

Aggressive traders use the channel patterns to enter and exit trades whenever the price touches the channel lines. The channel patterns help the traders to get some clarity about future price movement.

For example, Aggressive traders usually go for a Buy when the channel touches the support, expecting the price to bounce from the bottom support line. In the same way, they go for a sell when the price touches the top resistance level of the channel.

The conservative traders wait for the channel to break before entering the trade to benefit from the expected significant price movement.

Rule of thumb:

1. The price movement inside an Ascending channel usually breaks at the support line.
2. The price breaks downward from an Ascending channel on the 4th or 5th touch on the support line.
3. When the price breaks downward, the first target is the width of the channel. (If the width of the channel is 'X' points, then the price will break downwards 'X' points)

Ascending Channel

NZD/USD Daily Chart

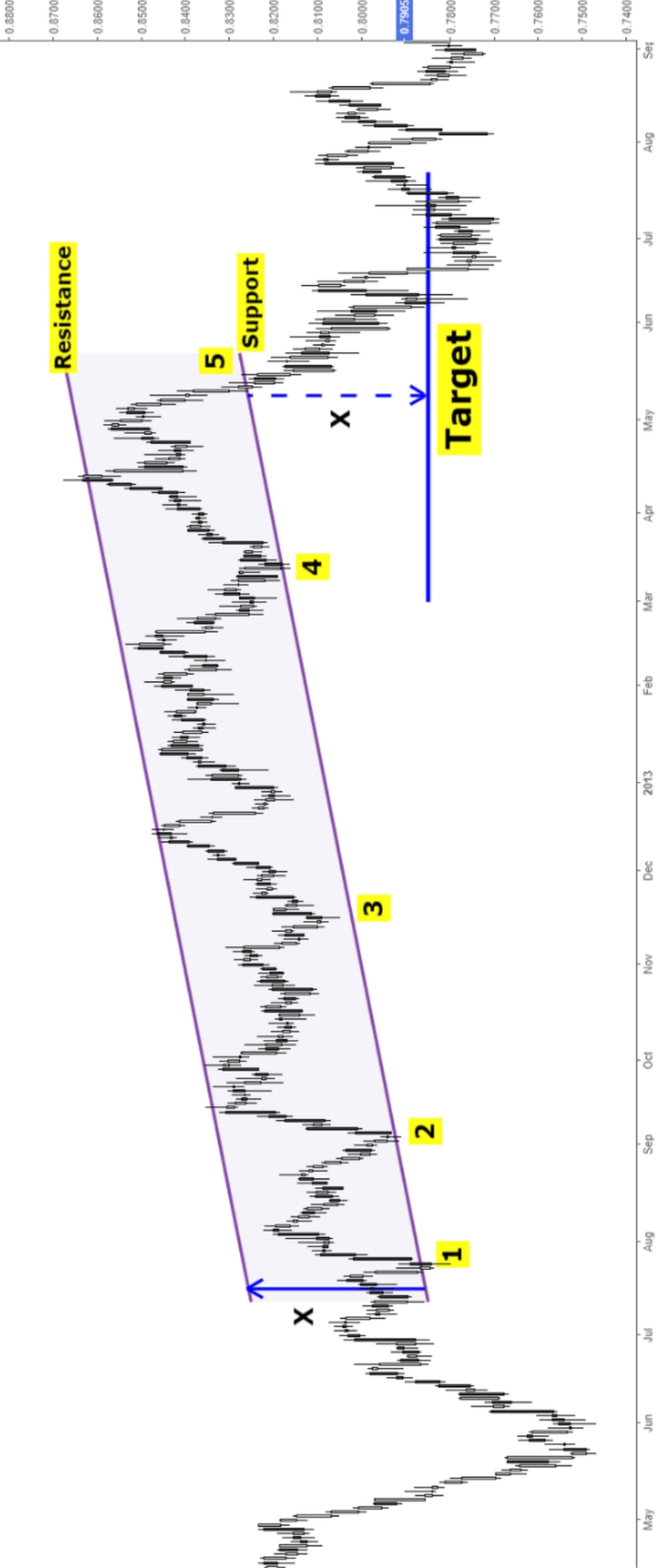


Figure 4.2

Figure 4.2 shows the forex daily price chart of the New Zealand Dollar/US Dollar.

- Here, the price bounced between the two rising parallel lines, forming an ascending channel.
- The price broke out of the ascending channel on the fourth touch on the support line.
- The price came down by X points (the width of the channel) to reach the next target.

5) Descending Channel Pattern

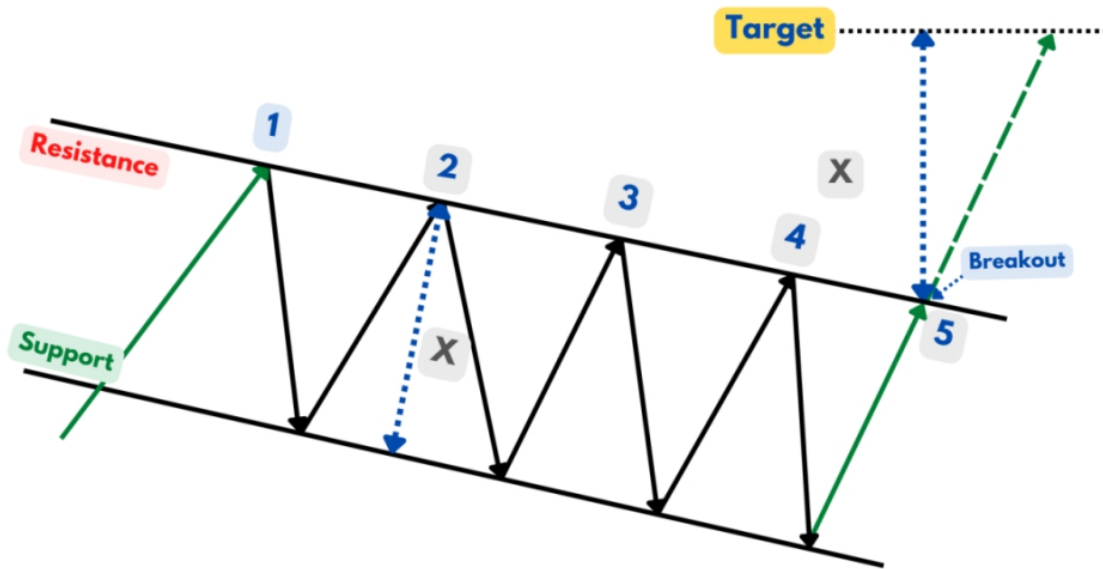


Figure 5.1

A Descending channel is just the opposite of an Ascending channel. It is formed by connecting the lower highs and lower lows of the price of a security with two parallel lines. A descending channel shows a downward trend just before an upward price movement. A descending channel often appears in an uptrend.

Even though the descending pattern indicates possible bullish movement, traders usually use this pattern to buy and sell whenever the price touches the upper or lower channel line, carefully watching for a breakout. The

price movement will be much faster when the breakout happens than when it happens inside the channel.

Rule of thumb:

1. The price movement inside a Descending channel usually breaks at the top.
2. The price breaks out upwards from a descending channel on the 4th or 5th touch on the resistance line.
3. When the price breaks upward, the first target is the width of the channel. (If the width of the channel is 'X' points, then the price will break upward by 'X' points)

Descending Channel

NZD/JPY Daily Chart

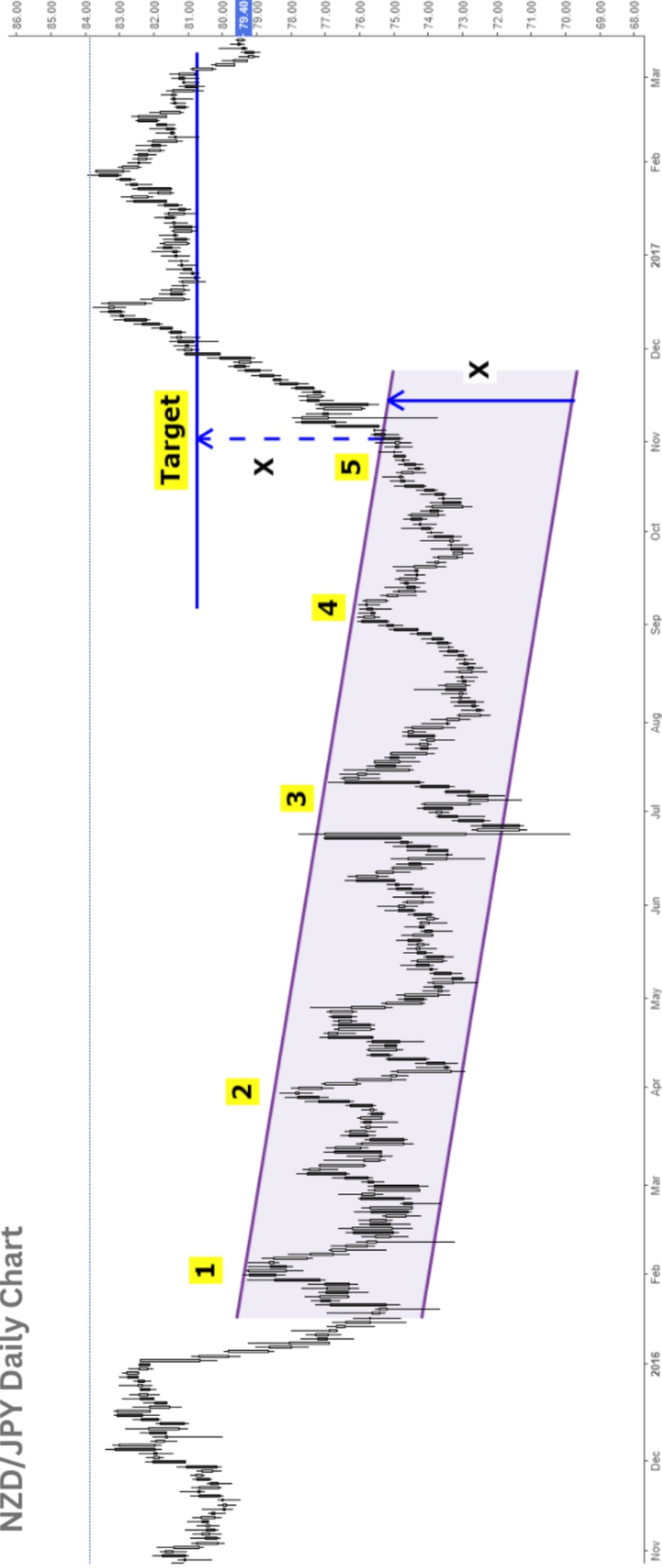


Figure 5.2

Figure 5.2 shows the Forex daily price chart of the New Zealand Dollar /Japanese Yen.

- The figure shows a reversal of the trend's direction.
- The price fell to bounce from the support line to point one, and then it bounced between two falling parallel lines, forming a descending channel pattern.
- Here the sellers tried to lower the asset's price, but in the end, the buyers won.
- The price broke out of the Descending channel X points upward from point 5 to reach the next target.

6) Bullish Flag Pattern

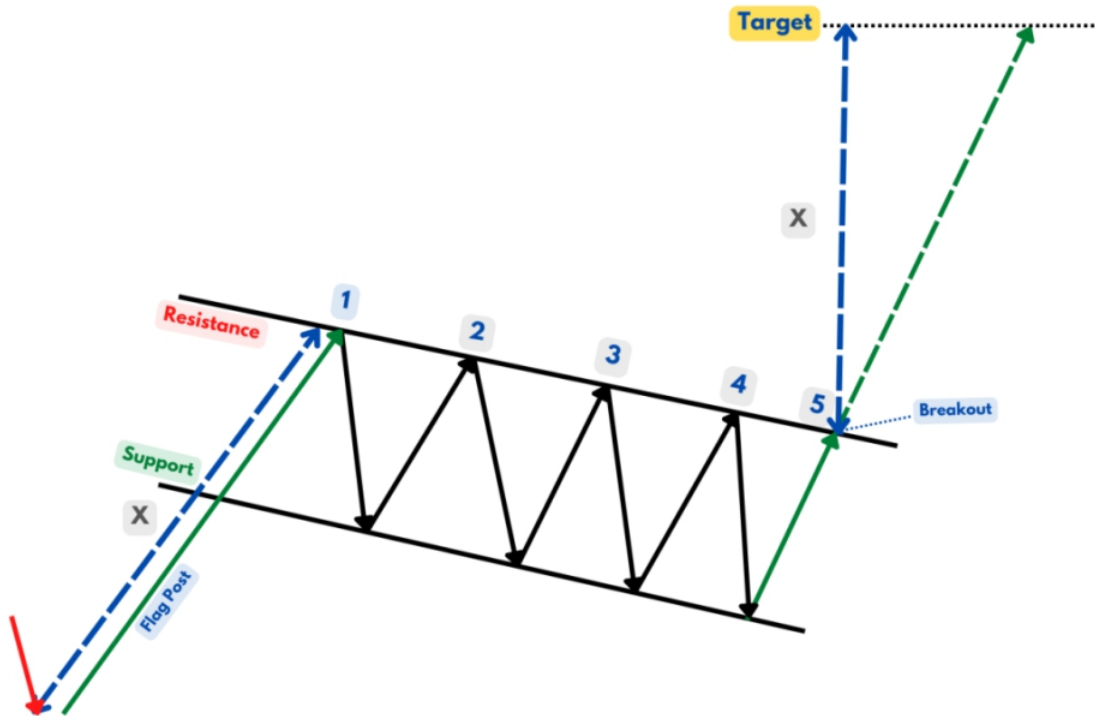


Figure 6.1

The Flag pattern is a continuation pattern. As the name suggests, the flag pattern looks like a flag. It is very similar to Channel Patterns with an attached Flag pole.

A bullish flag shows a sharp increase in the asset's price. Then it will start to move sideways between a support and resistance level that are parallel to each other. The result is a descending channel and indecision for buyers and sellers. Usually, in a bullish flag, the price breaks the resistance level and continues to move upward. Once the breakout happens, there will be a

sharp increase in the asset's price. The length of the flag pole is considered its target in the upward direction.

Rule of thumb:

1. The Flag pattern is a continuation pattern.
2. The price movement inside a Bullish Flag Pattern usually breaks at the topside.
3. The price breaks out upwards from a Bullish flag on the 4th or 5th touch on the Resistance line.
4. When the price breaks upward, the next target is the height of the Flag post/pole. (If the size of the flag post is 'X' points, then the price will break upward 'X' points)

Bullish Flag

USD/CHF 30 Min Chart

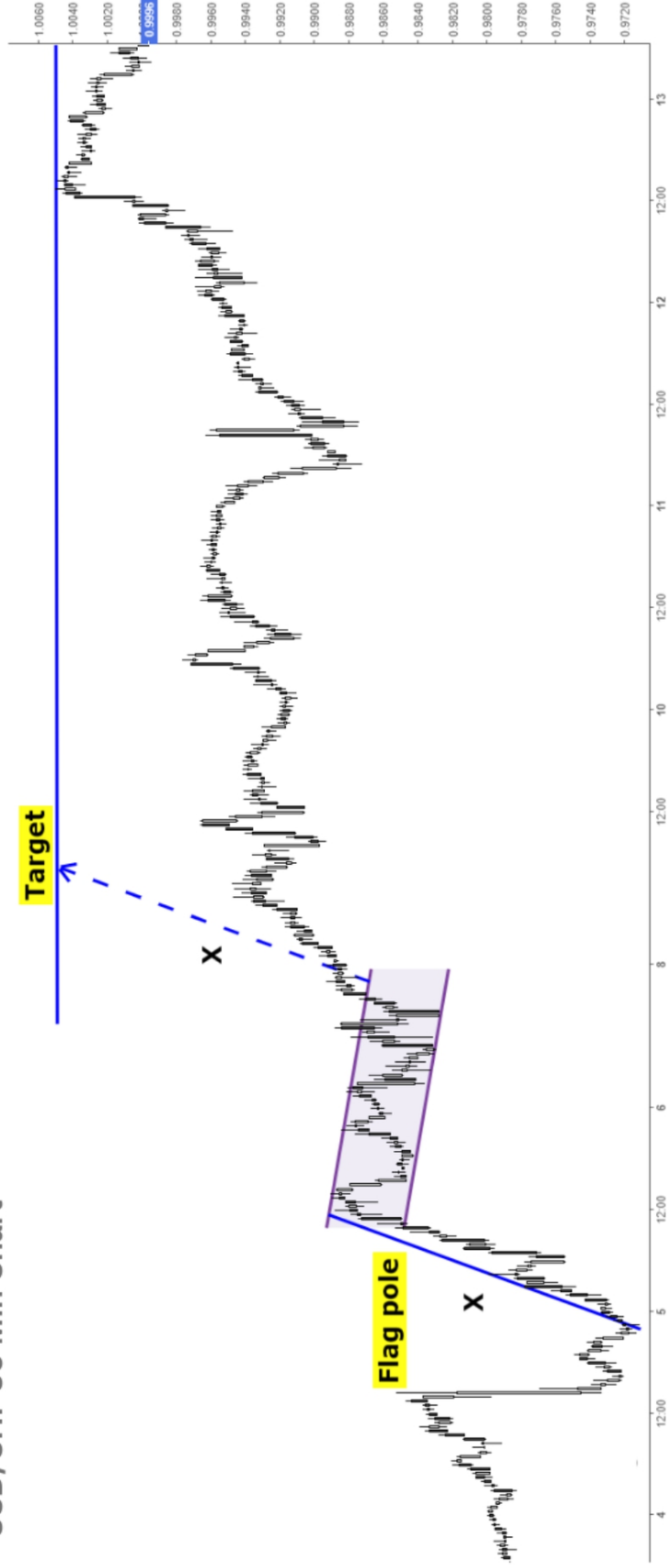


Figure 6.2

Figure 6.2 shows the Forex 30-minutes price chart of the US Dollar/Swiss Franc.

- Here there was a sharp increase in price, forming the flag pole(X points)
- Then the price consolidated in a Descending channel pattern, indicating indecision between buyers and sellers.
- Then the buyers became stronger again, and the price moved upward to the target X points from the break-out point.

7) Bearish Flag Pattern

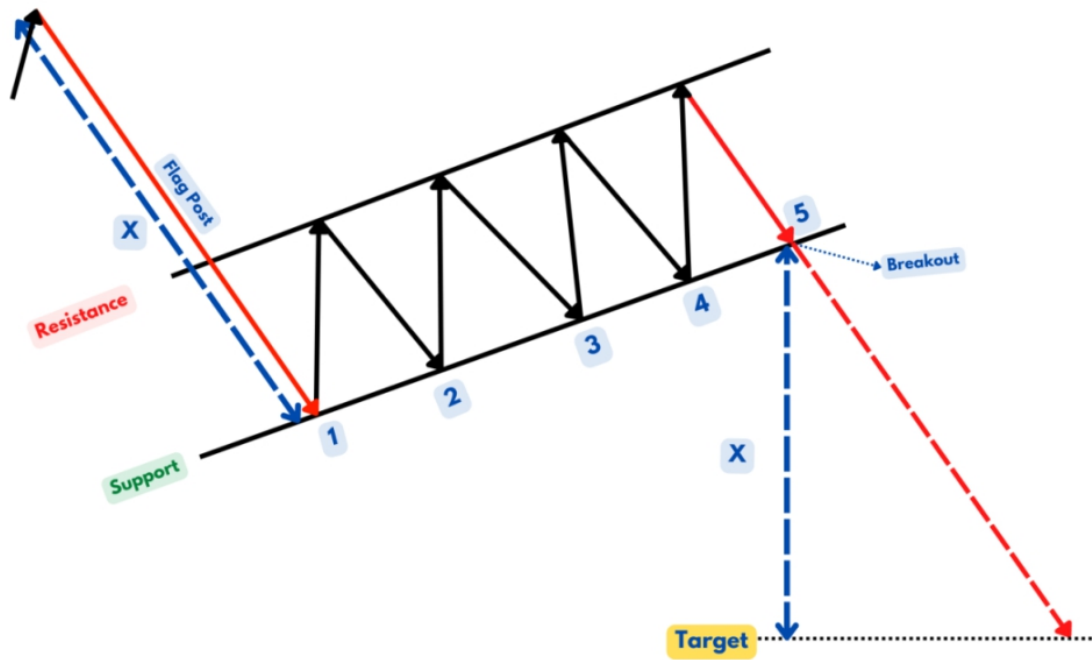


Figure 7.1

A Bearish Flag pattern indicates that prices may move downward in the future. It is just the opposite of the Bullish flag pattern.

The steady price movement in the downtrend forms an ascending channel. The price then bounces between the channel support and resistance lines before breaking out of the channel. Once the breakout happens in a bearish flag pattern, the price movement in the downward direction will be much faster.

Rule of thumb:

Most of the time, the price breaks out downward from a Bearish flag on the 4th or 5th touch on the Support line.

1. The price movement inside the Bearish Flag Pattern usually breaks to the downside.
2. Most of the time, the price breaks out downward from a Bearish flag on the 4th or 5th touch on the Support line.
3. When the price breaks downward, the next target is the height of the Flag post/pole. (If the size of the flag post is 'X' points, then the price will break downward 'X' points)

Bearish Flag

Associated British Foods
PLC 4 Hour Chart

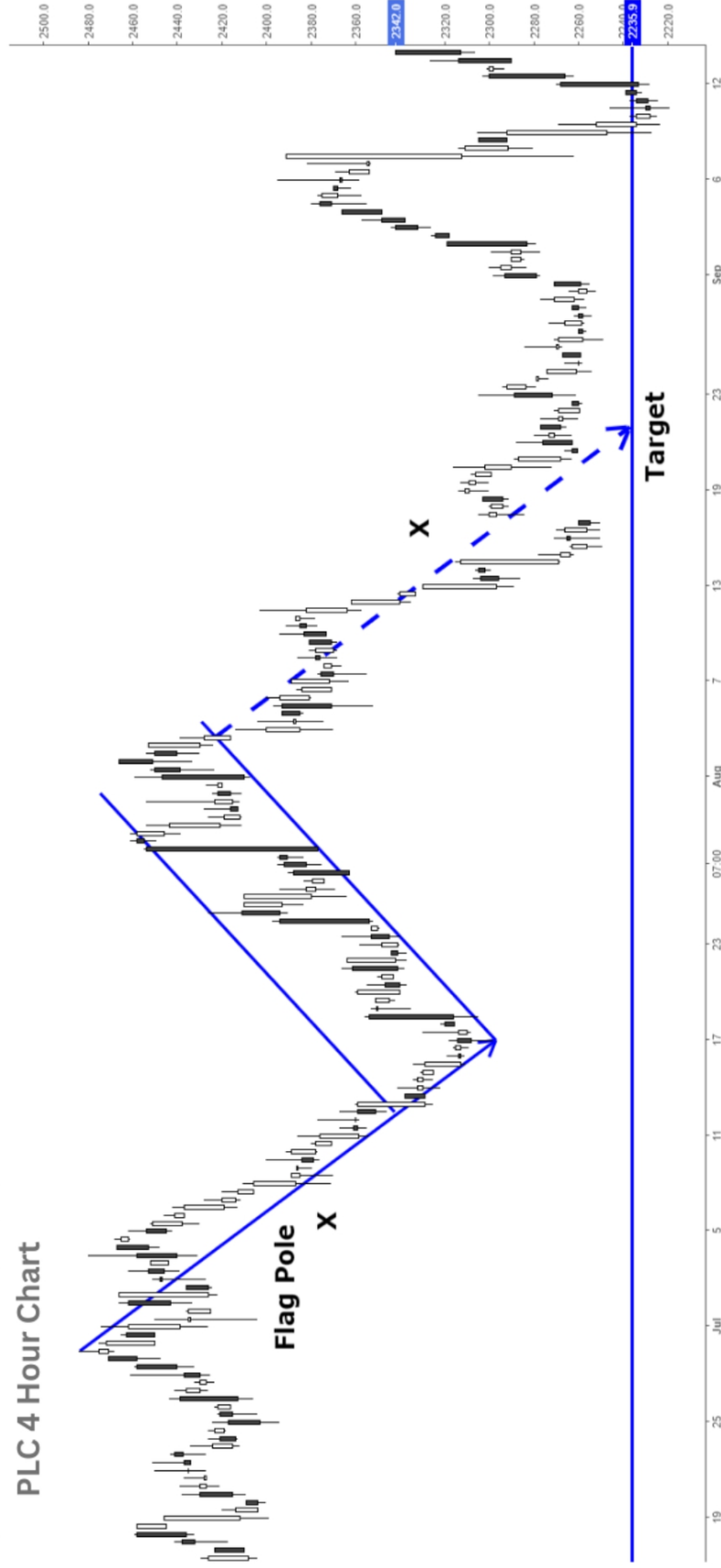


Figure 7.2

Figure 7.2 shows the four-hour stock price chart of Associated British Foods PLC.

- Here, the price moved almost like a Double bottom. However, the pattern failed to complete the Double bottom since the price took a U-turn before reaching the Neckline.
- The price moved in the form of an inverted flag, resulting in the price breaking out of the flag pattern downward.
- The price moved X points (the length of the flag post) down to hit the target level.

8) Ascending Triangle Pattern

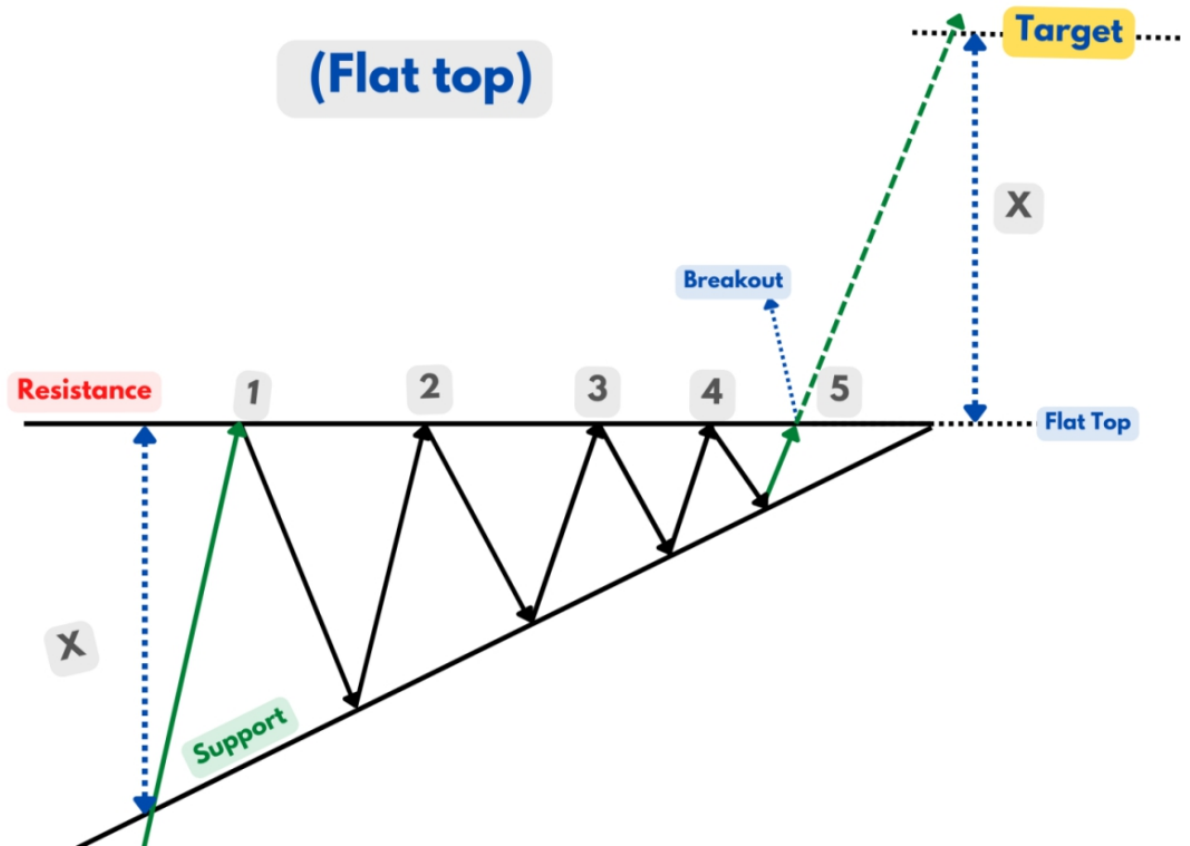


Figure 8.1

An ascending triangle is also known as a rising triangle. It is one of the top continuation patterns that appears in the middle of a trend. It is formed by a horizontal trendline connecting swing highs and a rising trendline connecting swing lows. These two lines form a triangle. The Ascending Triangle indicates the possible continuation of price in the upward direction. The resistance line is almost flat and remains unchanged, while the support line rises with price movement. The rising trendline shows that the buyers are more substantial than the sellers. When the price breaks upward, the pattern is complete.

Rule of thumb:

1. The price movement inside an Ascending triangle usually breaks at the top.
2. Most of the time, the price breaks out upward from Ascending Triangle on the 4th or 5th touch on the Resistance line.
3. When the price breaks upward, the next target is the height of the Triangle. (If the height of the Triangle is 'X' points, then the price will break upward 'X' points)
4. The Ascending Triangle is considered valid when formed in an uptrend.

Advantages :

- This pattern is easy to identify and has target-level clarity.

Ascending Triangle

Walgreens Boots Alliance Inc Daily Chart

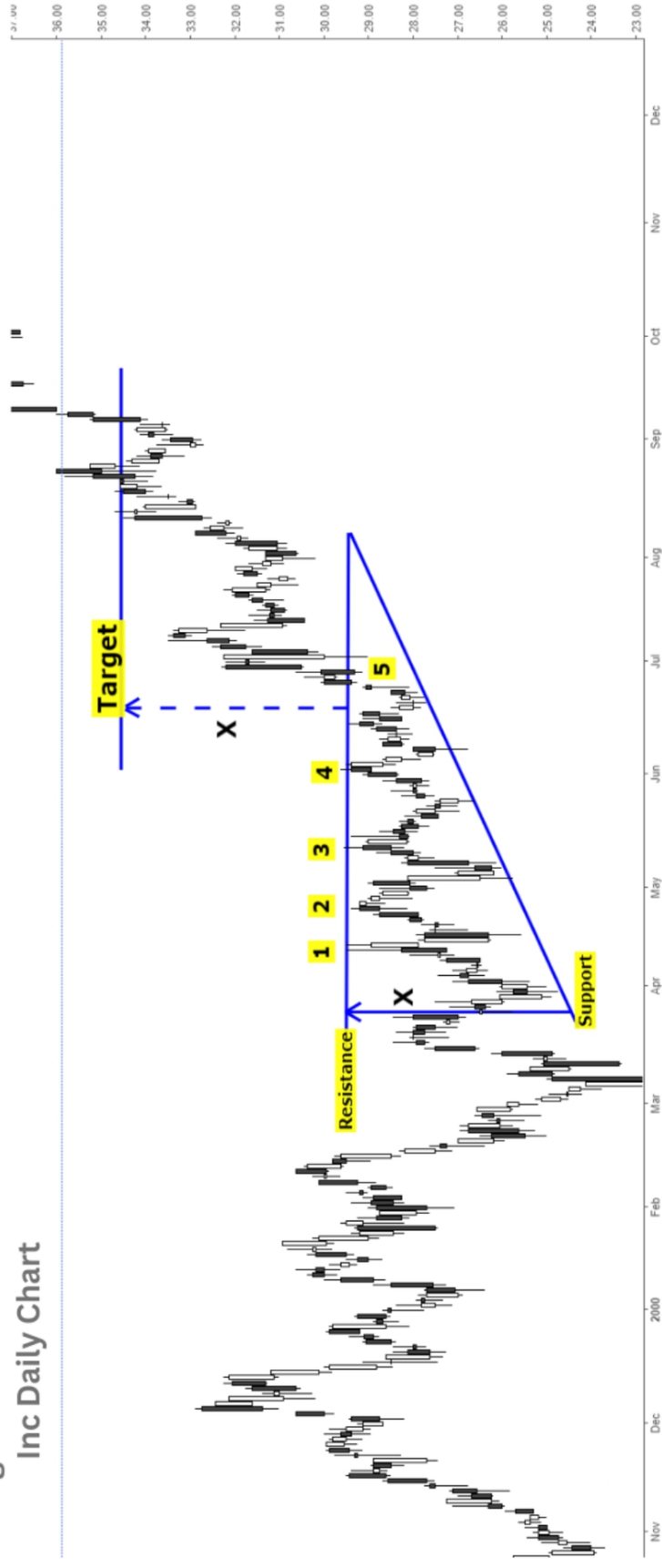


Figure 8.2

Figure 8.2 shows the daily price chart of the stock Walgreen boot.

- The price movement could not break the first resistance line (Marked as support).
- The price failed to break the resistance lines many times, but it started to consolidate closer to the resistance line.
- Here the price is making newer Higher lows, with the top-level remaining the same by creating Ascending channel pattern.
- The price broke out of the resistance line on the fifth touch and moved upward.
- The price reaches the target X points up, which is the Ascending triangle's height.

9) Descending Triangle Pattern

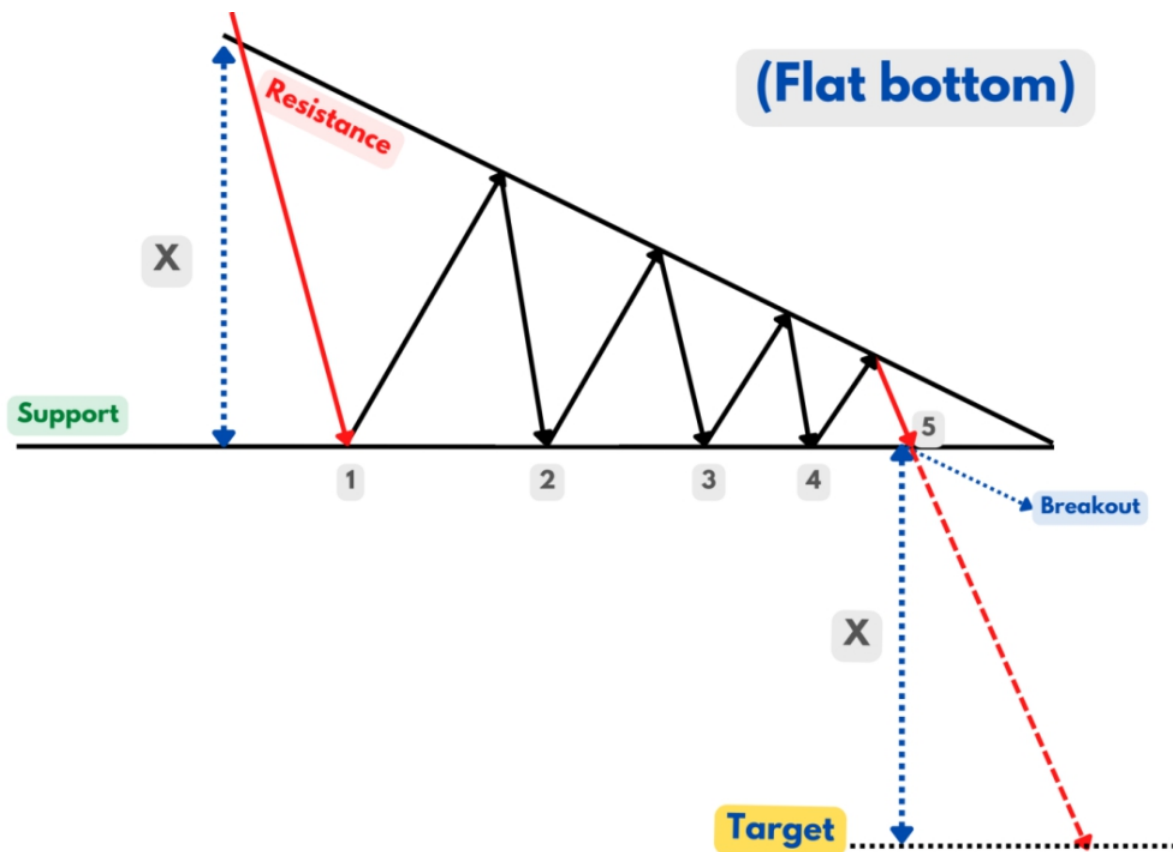


Figure 9.1

A Descending triangle, or falling triangle, is a bearish continuation pattern. This pattern shows that sellers are more vital than buyers. A descending triangle consists of a horizontal trend line connecting the lows and a falling trend line that connects the highs. The support line is almost flat, and the resistance line is descending downward. The breakout happens downward from the support line. When the price starts to form a descending triangle pattern, traders usually order to open a short position (SELL) at the support level with a stop loss placed above the resistance level.

Rule of thumb:

1. The price movement inside a Descending triangle Pattern usually breaks to the downside.
2. The price breaks downward from a Descending triangle on the 4th or 5th touch on the Support line.
3. When the price breaks downwards, the next target is the height of the Descending triangle. (If the height of the triangle is 'X' points, then the price will break downward 'X' points)
4. The Descending Triangle is considered valid when formed in a downtrend.

Descending Triangle

USD/CAD Daily Chart

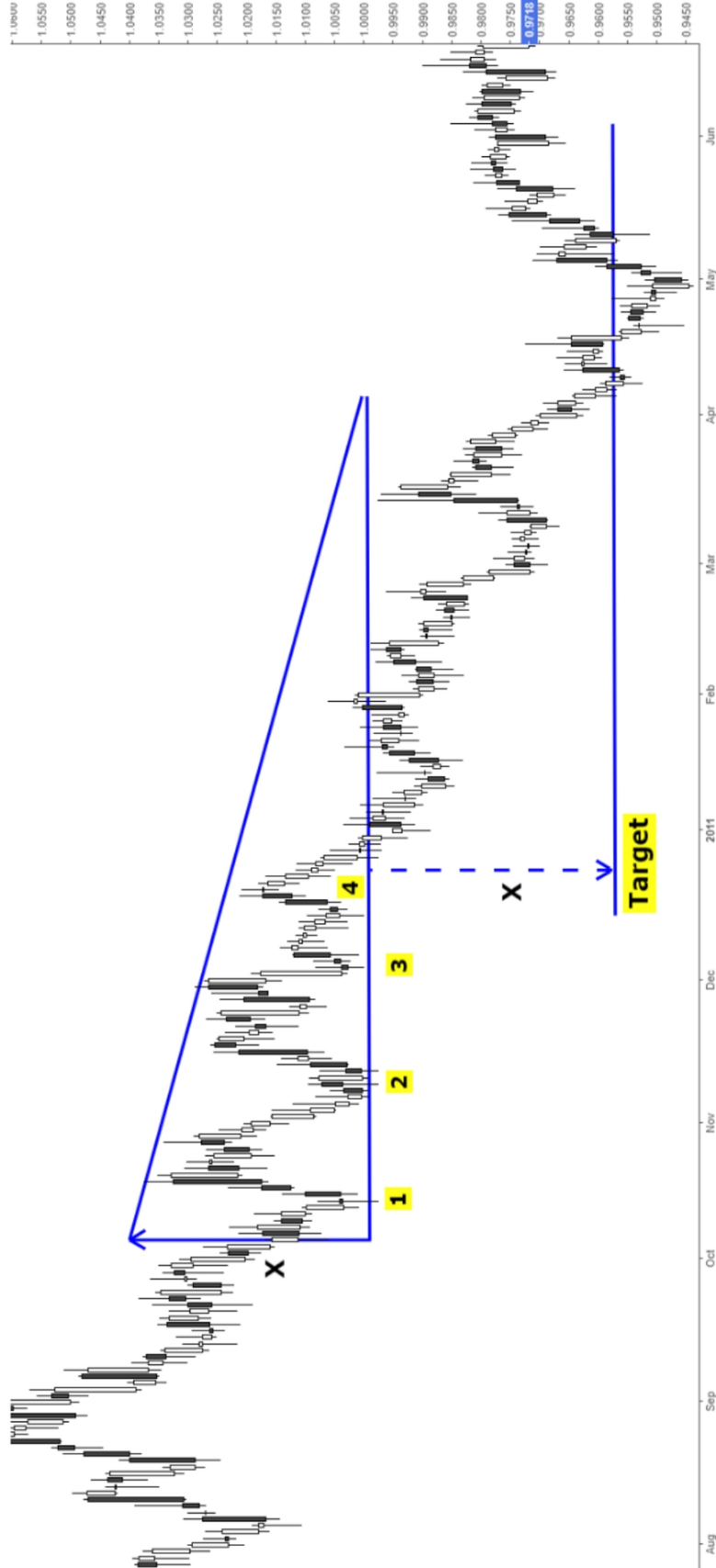


Figure 9.2

Figure 9.2 shows the forex daily price chart of the US Dollar/Canadian Dollar.

- Here, the price movement could not break the first support line.
- The price failed to break the support level many times, but it started to consolidate closer to the support.
- Here, it is evident that the price is making new Lower highs, with the bottom level remaining the same, creating a Descending channel pattern.
- The price broke out of the support line on the fourth touch and moved downward.
- The price hit the target X points down, which is the height of the Descending triangle.

10) Symmetric Triangle Pattern

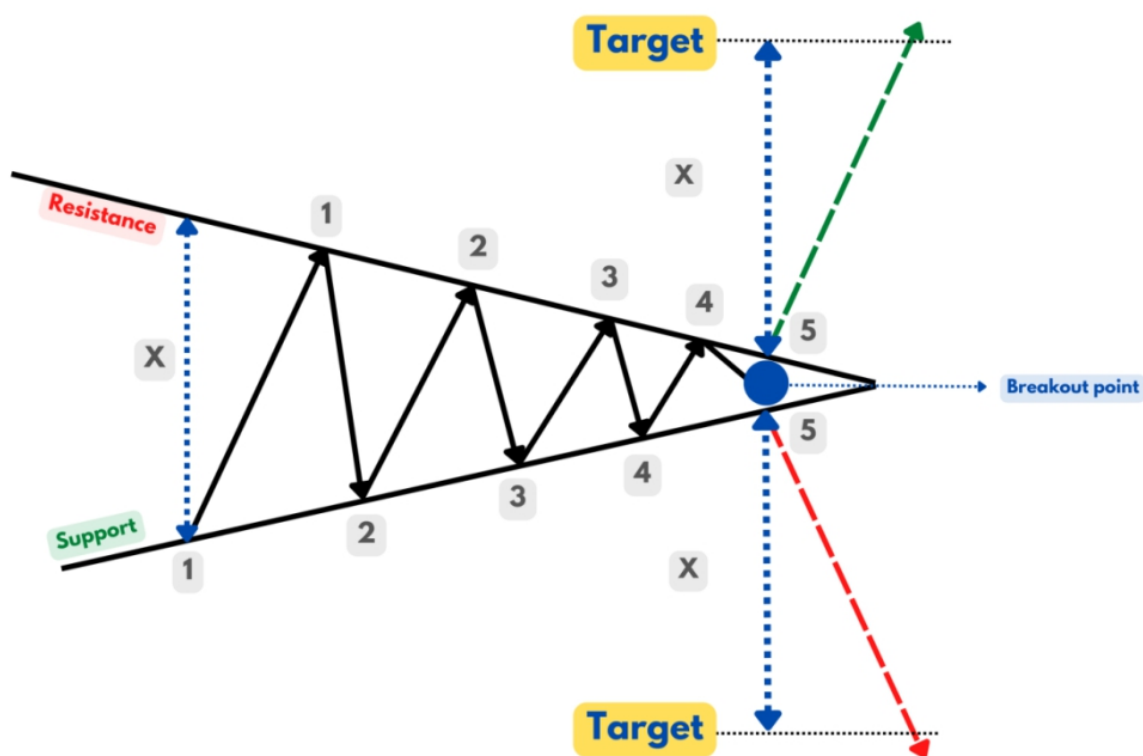


Figure 10.1

A symmetric triangle is a combination of Ascending triangles and descending triangles. Symmetric triangles are neutral patterns, which means the breakout can occur either upwards or downwards. It is impossible to predict in which direction the breakout will happen. Most smart traders expect a symmetric triangle to break out in the direction of the trend. Traders often watch for breakouts from a symmetric triangle to enter trades in the direction of price movement. If in an uptrend, a possible breakout of the symmetrical triangle would be in the upward trend, and vice versa. Following a breakout from a symmetric triangle, traders tend to buy or sell aggressively, depending on the price's direction.

Rule of thumb:

1. The price movement inside a Symmetrical triangle Pattern could break out upward or downward.
2. The price breaks out, which often happens on the 4th or 5th touch on the Support or Resistance line.
3. When the price breaks downwards or upwards, the next target is the height of the Symmetric triangle. (If the height of the triangle is 'X' points, then the price will break downwards or upwards by 'X' points)
4. In many cases, a symmetric triangle breakout happens in the direction of the trend.

Symmetric Triangle

XAU/USD Daily Chart

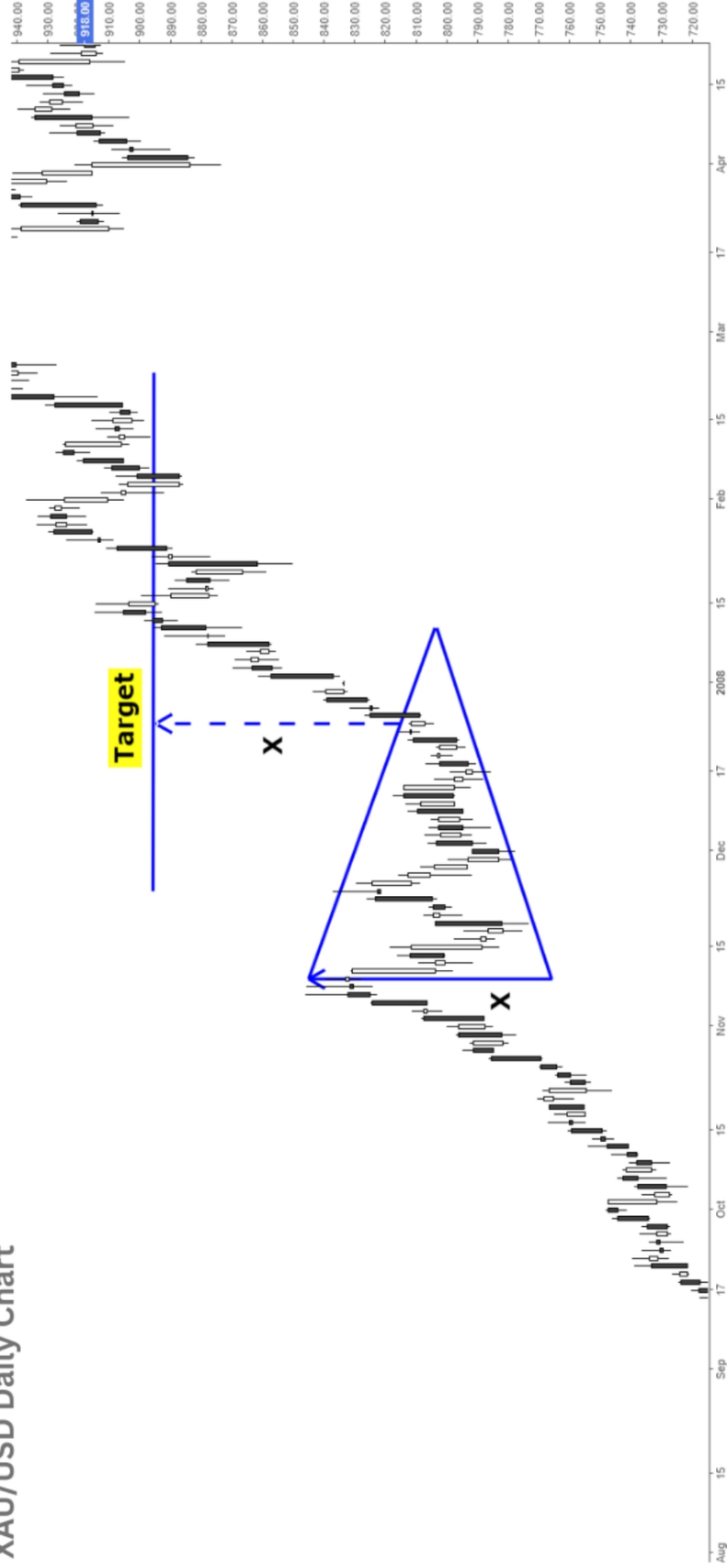


Figure 10.2

Figure 10.2 shows the Gold spot/US Dollar Daily price chart.

- Here the price made a new High, then a few consecutive higher lows (HL), then lower Highs (LH) almost three times. A symmetric triangle formed as a result of the price consolidation.
- In the above chart, the buyers became more powerful than the sellers, and the price broke out of the Symmetric triangle in an upward direction.
- The target is the height of the symmetric triangle (X points) in the upward direction.

11) Rising Wedge Pattern

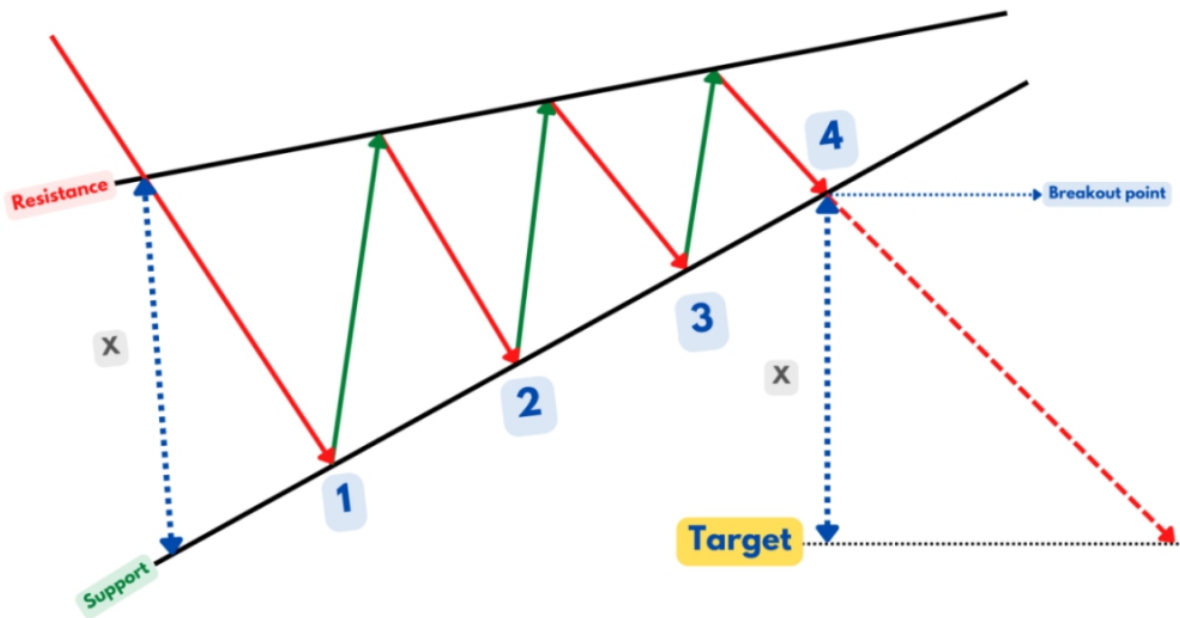


Figure 11.1

A rising wedge pattern looks similar to triangle patterns but works differently. Two rising trendlines combine to form a bearish chart pattern known as the rising wedge. It is a bearish continuation pattern in a downtrend. When a rising wedge forms in an uptrend, it is considered a reversal pattern that changes the price direction to the downside .

Rule of thumb:

1. The price movement inside a Rising wedge Pattern usually breaks to the downside.
2. Most of the time, the price breaks down from a Rising wedge Pattern on the 4th or 5th touch on the Support line.
3. When the price breaks downward, the next target is the height of the Rising wedge Pattern. (If the height of the wedge is 'X' points, then the price will break downward by 'X' points)

Rising Wedge

Vanguard Russell 2000 Index Daily Chart

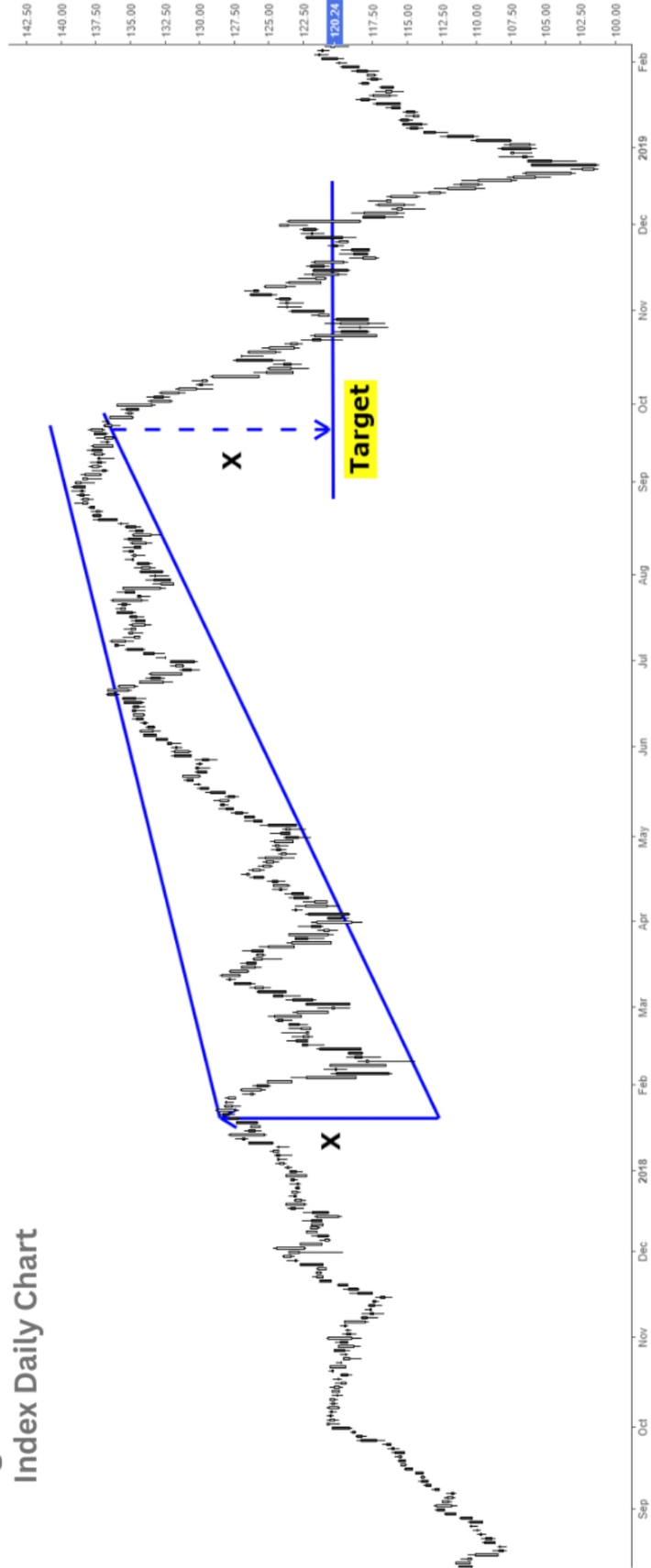


Figure 11.2

Figure 11.2 shows the daily price chart of the Russel 2000 Index.

- Here the price is in an uptrend, which moves inside two rising trend lines, forming the Rising Wedge Pattern.
- The height of the Rising wedge is X points.
- The price inside the wedge touched the lower support line four times and broke down from there on the fifth touch.
- Then there was a sharp fall in the price towards the next target: X points down from the breakout point.

12) Falling Wedge Pattern

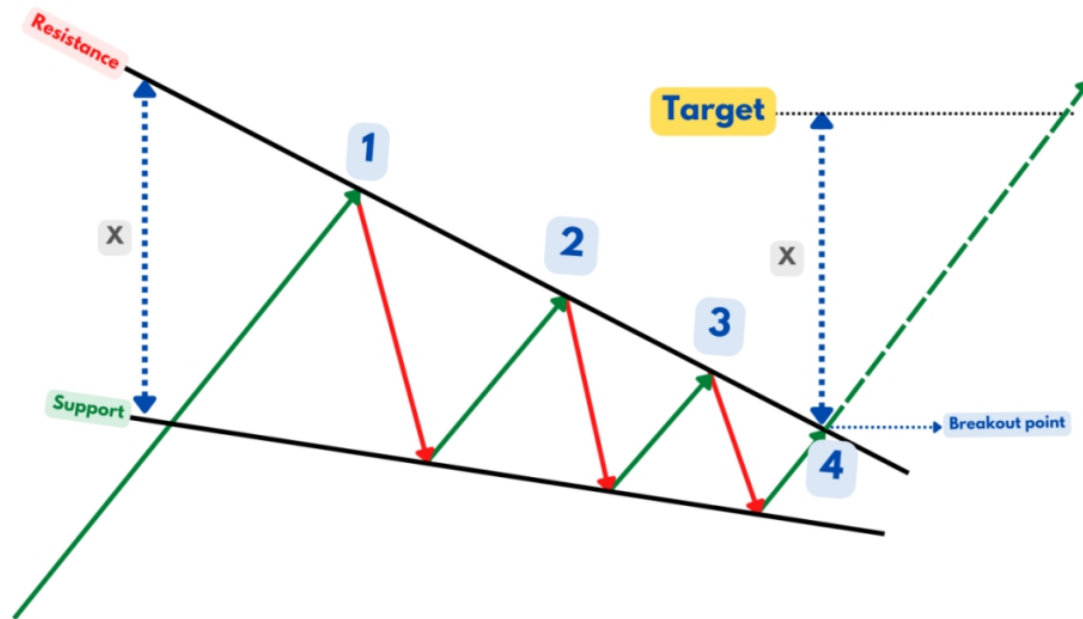


Figure 12.1

A falling wedge pattern is just the opposite of a rising wedge pattern. Two falling trendlines have formed a bullish chart pattern. In an uptrend, it is a bullish continuation pattern. When formed in a downtrend, a falling wedge pattern is considered a reversal pattern that changes price direction to the upper side.

Rule of thumb:

1. The price movement inside a falling wedge pattern usually breaks at the upper side when in an up trend.
2. When in a downtrend, the falling wedge Pattern reverses the price direction to the upper side.
3. The price usually breaks out upward from a falling wedge pattern on the 4th or 5th touch on the Resistance line.
4. When the price breaks upward, the next target is the height of the falling wedge pattern. (If the height of the wedge is 'X' points, then the price will break upward 'X' points).

Falling Wedge

XAU/USD Daily Chart

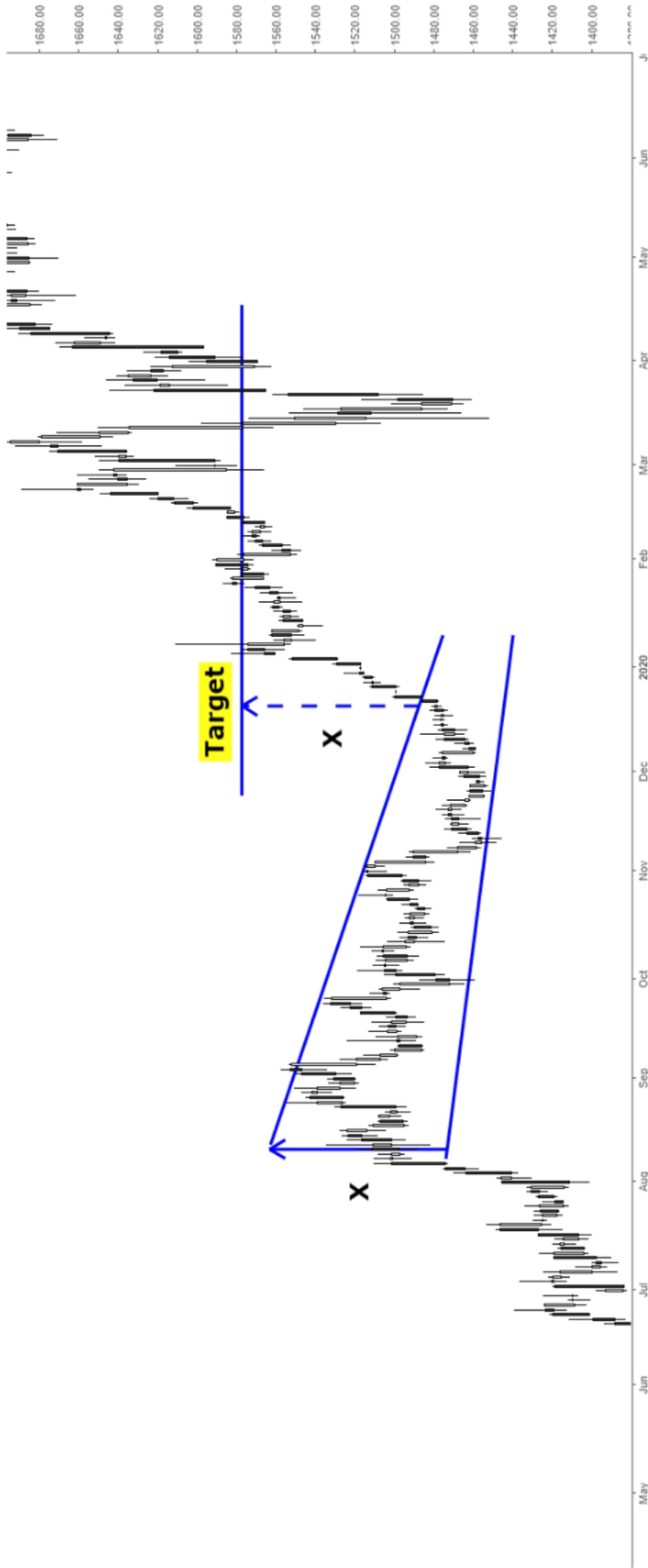


Figure 12.2

The daily price chart of Gold Spot/US Dollar is shown in Figure 12. 2 .

- Here the price is in an uptrend, which moves inside two falling trend lines, forming the Falling Wedge Pattern.
- The height of the Falling wedge is X points.
- The price inside the wedge touched three times on the top resistance line and broke upwards on the fourth touch.
- Then there was a sharp increase in the price towards the next target: X points upwards from the breakout point.

13) Head & Shoulder Pattern

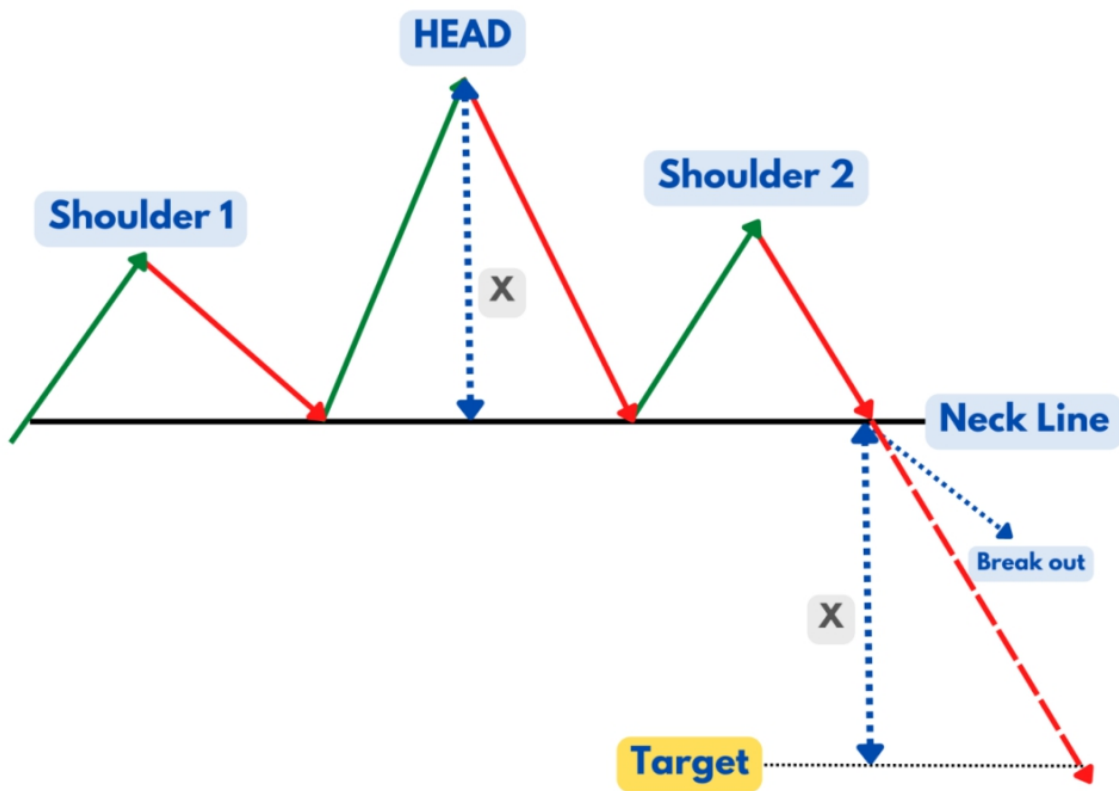


Figure 13.1

Head and shoulders is one of the most highly analyzed and effective patterns to predict the price movement of a financial asset. The head and shoulders pattern consists of three peaks. There is one head peak and two shoulder peaks on either side. There is a shallow trough between the left shoulder and head and another shallow trough between the right shoulder and head. It is a strong reversal pattern that indicates the end of an uptrend. When this pattern is completed, intelligent traders switch to aggressive selling mode.

Rule of thumb:

1. The Head and shoulders pattern indicates bearish price movement.
2. The price usually breaks at the neckline to the downside.
3. When the price breaks downwards, the next target is the height of the Head (if the height of the head is 'X' points, then the price will break downwards by 'X' points)
4. Sometimes, a head and shoulders pattern appears with one extra shoulder to the right, indicating a powerful bearish movement.

Head & Shoulder

GBP/JPY Weekly Chart

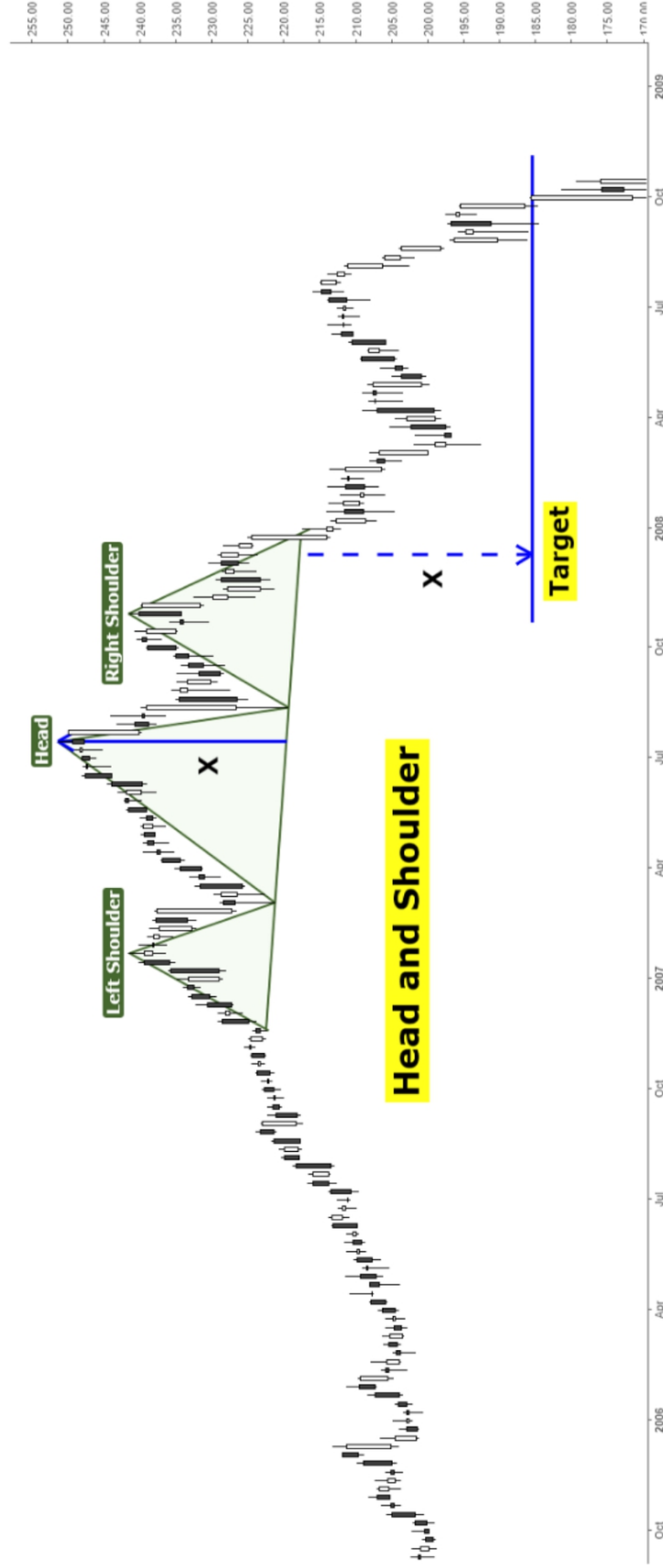


Figure 13.2

The Weekly Forex price chart of the British pound/Japanese yen is shown in Figure 13.2.

- The upward price movement falls back to the support line (the Neckline) three times, forming three peaks.
- The middle peak, the Head, is bigger than the left and right shoulder peaks.
- The height of the Head peak is X points.
- The price movement in the Head and shoulders pattern breaks down from the Neckline support and goes downward.
- The price moves to the target, which is X points downward.

14) Inverse Head & Shoulder Pattern

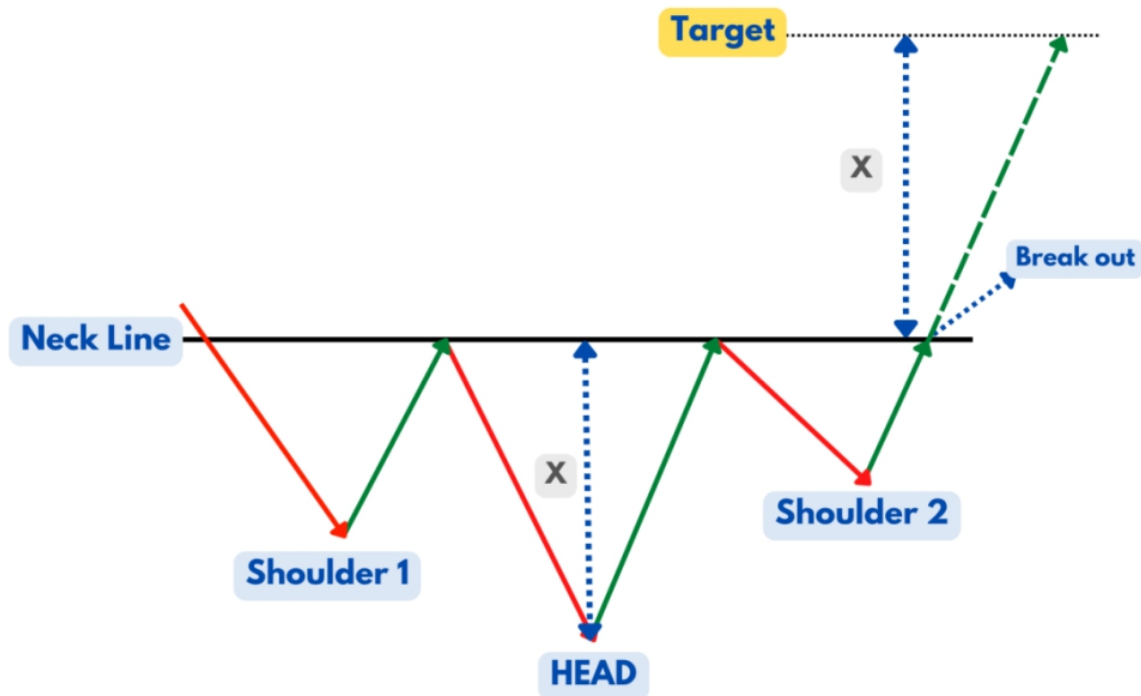


Figure 14.1

The Inverse Head and Shoulders pattern is a strong reversal pattern that leads to strong movement in the opposite direction. It is just the opposite of the standard "Head and shoulders" pattern. This pattern mostly appears in a downtrend, which indicates the reversal of a downtrend into an uptrend. Smart traders start to buy aggressively when the Inverse head-and-shoulders pattern is complete.

Rule of thumb:

1. Inverse Head and Shoulders pattern indicates bullish price movement.
2. Typically, the price breaks at the neckline to the upper side. .
3. When the price breaks upwards, the next target is the height of the inverted Head (If the height of the Head is 'X' points, then the price will break upwards by 'X' points)
4. If an inverse head and shoulders pattern appears with one extra shoulder, it indicates a powerful bullish movement.

Inverse Head & Shoulder

EUR/USD Daily Chart

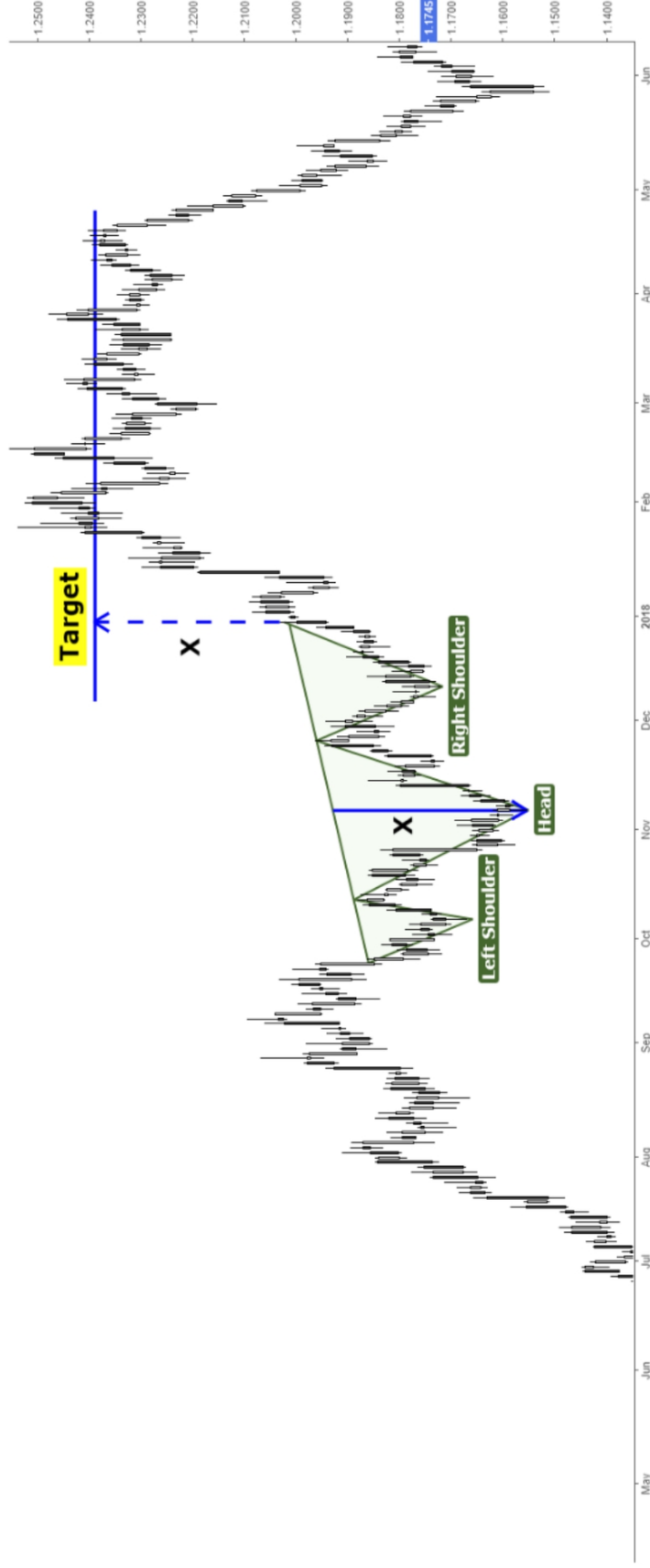


Figure 14.2

Figure 14.2 shows the daily forex chart of the Euro/US Dollar.

- The price movement touched the resistance line (the Neckline) three times, forming three inverted peaks (One Head and two Shoulders).
- The height of the Head peak from the Neckline is X points.
- The price movement of the Inverted Head and shoulders breaks out from the Neckline support and moves upwards.
- The price moves X points to the target and in the upward direction.

15) Cup & Handle Pattern

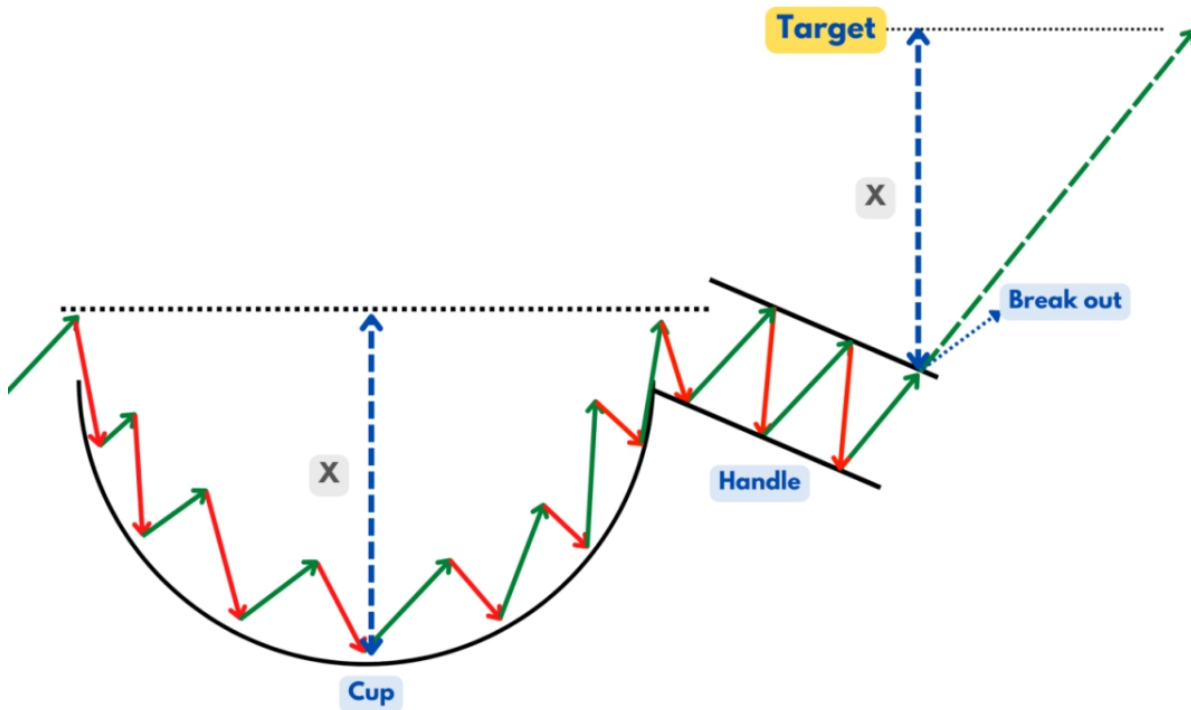


Figure 15.1

The cup and handle pattern is a bullish continuation pattern. The formation of this pattern in an uptrend indicates that the price will continue to move in an upward direction. In this pattern, the price movement forms the shape of a bowl or a cup. Then the price consolidates for a short period in the form of a descending channel or sometimes a flat rectangle, becoming the handle. The price usually breaks upward from this handle.

Rule of thumb:

1. The cup and handle pattern indicates bullish price movement.
2. The shape of the cup is significant. The cup & handle pattern must have a "U" rather than a "V" shape, with both edges of the cup almost at the same level.
3. The cup handle can be a descending channel or a flat rectangle from which the breakout happens upwards.
4. The target is the height of the cup. (If the height of the cup is 'X' points, then the price will break upward 'X' points).

Cup & Handle

EUR/USD Daily Chart

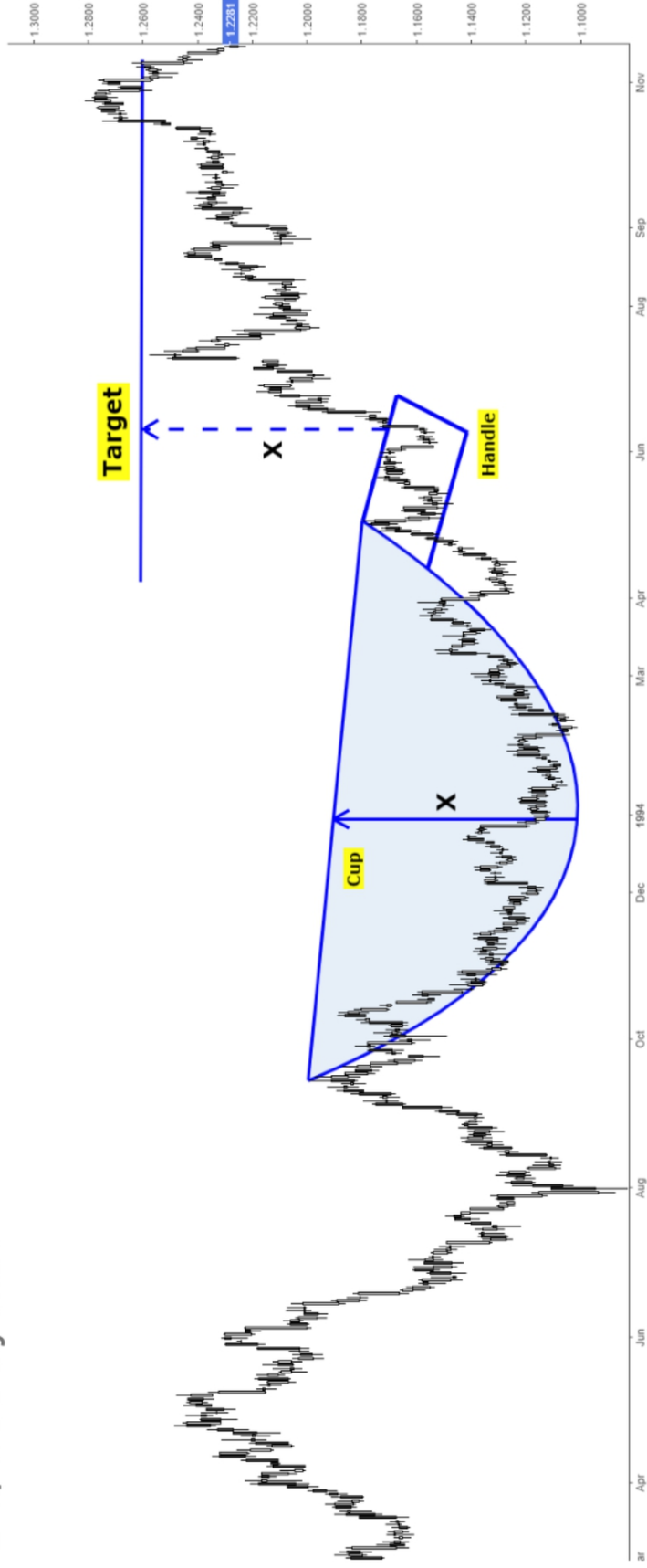


Figure 15.2

Figure 15.2 shows the Cup and Handle pattern on the Euro/US Dollar Forex price chart.

- First, the price moves down and then goes back up, forming the shape of a bowl.
- The price then consolidates inside a channel for some time, forming the Descending channel and completing the Cup and Handle pattern.
- The height of the Cup is X points.
- The price breaks out of the Handle (Descending channel) in the upward direction.
- There is a sharp increase in price towards the target, which is X points away in the upward direction.

16) Inverted Cup & Handle Pattern

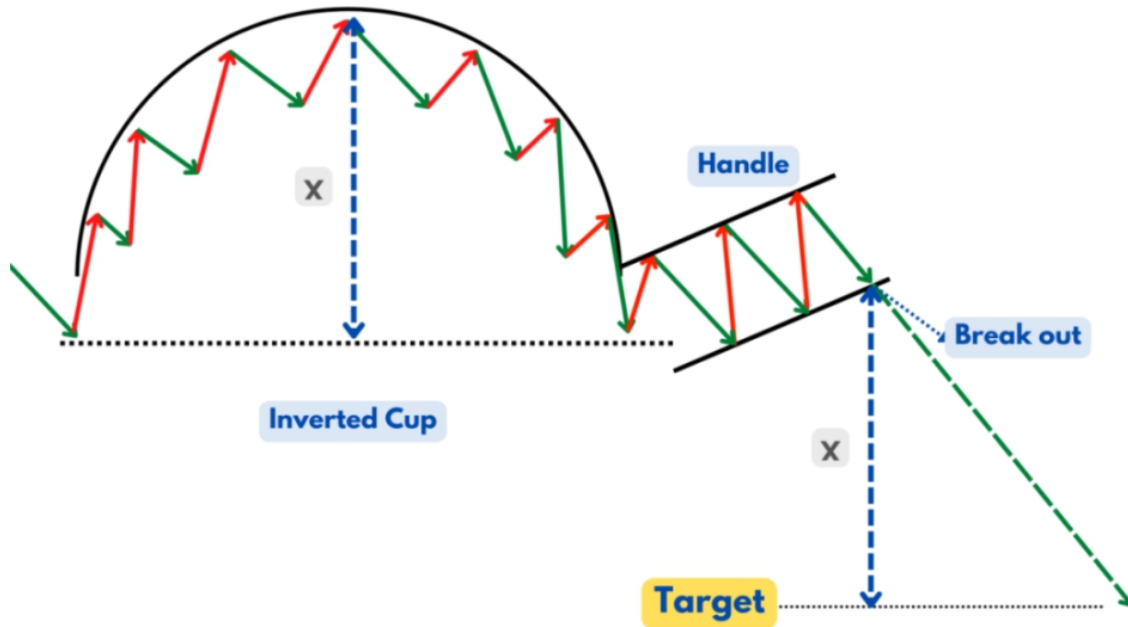


Figure 16.1

The Inverted cup and handle pattern is the opposite of the cup & handle pattern. The Inverted cup and handle is a bearish continuation pattern. The price moves in the shape of an inverted semi-circle followed by an ascending channel. This completes the Inverted Cup and handle pattern. The price usually breaks downward from the handle .

Rule of thumb:

1. The Inverted cup and handle pattern indicates bearish price movement.
2. The shape of the cup is significant. The Cup and handle pattern must have a "U" rather than a "V" shape, with both edges of the cup almost at the same level.
3. The cup handle can be an ascending channel or a flat rectangle, from which the breakout happens downwards.
4. The target is the cup's height (If the Cup's height is 'X' points, then the price will break downwards by 'X' points).

Inverse Cup & Handle

EUR/USD Daily Chart

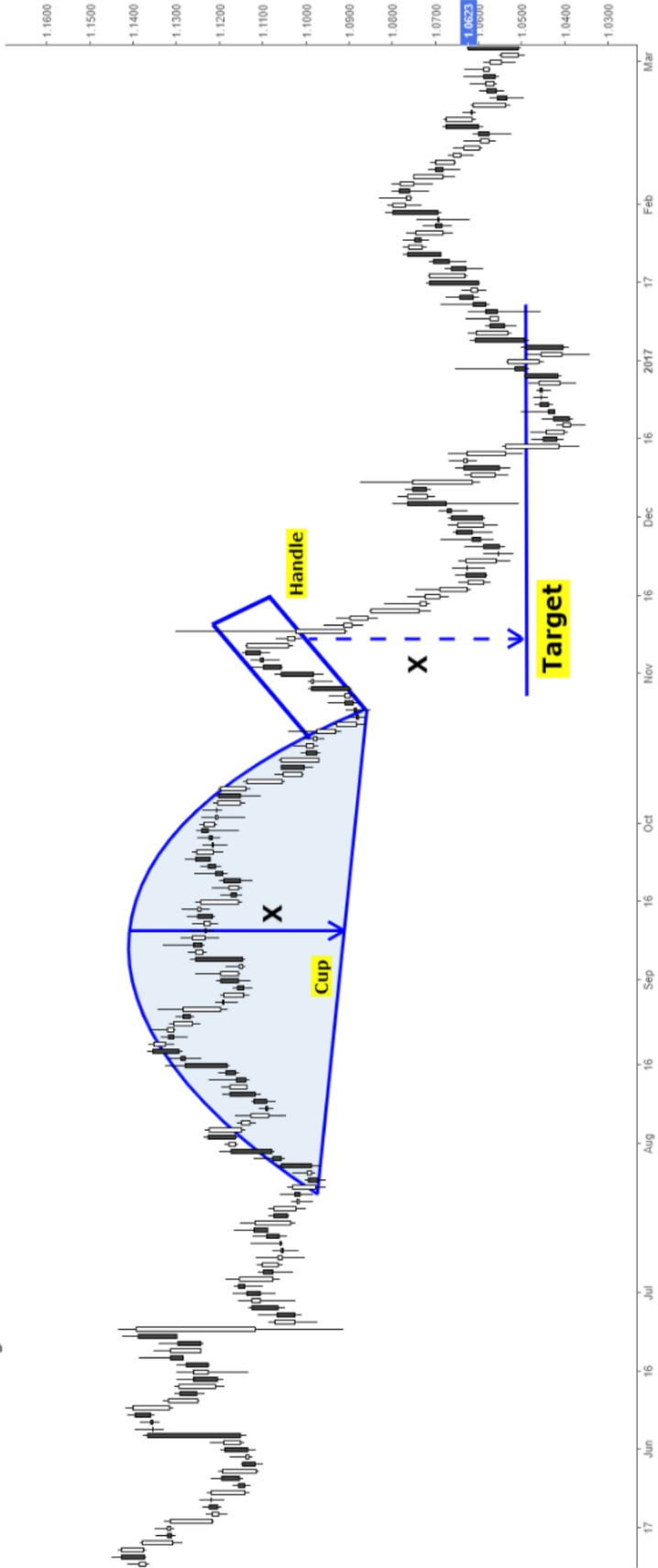


Figure 16.2

Figure 16.2 shows the daily forex price chart of the Euro/US Dollar.

- The price moves up and down, forming an inverted cup shape.
- The price moves up inside a small ascending channel and then breaks out of the channel downward.
- The price breaks out of the Handle (Ascending channel) in the downward direction.
- There is a sharp decrease in price towards the target, which is X points away from the breakout point.

Did You Know?

Through a pirate stock exchange, Somalians can buy shares in pirate bands that plan hijacking missions.

Chapter III

Fibonacci

What are Fibonacci numbers? How does it help with trading in financial markets?

Leonardo Fibonacci first popularised the Fibonacci numbers in the west in 1202. The numbers 0 and 1 are the base Fibonacci numbers. With 0 and 1 as the first two Fibonacci numbers, the following number in the sequence is derived by adding the last digit to the previous number.

E.g., 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

Now comes the exciting part. Fibonacci numbers come in a natural sequence. The Fibonacci series is also found in nature. For example, researchers found that the number of petals on most flowers in the world follows the Fibonacci sequence. Most flowers have petals 5, 8, 13, 21, etc. Even the cones in a pineapple follow the Fibonacci series. The breeding cycles of various animals also follow a Fibonacci number. Surprisingly, even the measurements of human body parts follow the Fibonacci sequence. When you divide a person's total height by the distance from their navel to their feet, you also get a Fibonacci Golden ratio.

Fibonacci Golden Ratio

1. Select any Fibonacci number in the sequence to find the Fibonacci golden ratio.
2. Dividing that number by the same number will give the first Fibonacci golden ratio of 1.
3. Divide the previous Fibonacci number by the chosen number to get the second Golden ratio, and so on.
4. You can find the Fibonacci golden ratio by dividing any Fibonacci number by the following number in order.

E.g., 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

Consider the above Fibonacci numbers.
Let's take number 144 and find the golden ratio.

- $144/144 = 1$
- $89/144 = 0.618$
- $55/144 = 0.382$
- $34/144 = 0.236$

So the above numbers **1, 0.618, 0.382, and 0.236** are called the **Fibonacci Golden Ratio** .

While used in trading, these numbers are converted to percentages, i.e., **23.6%, 38.2%, 61.8%, and 100%**.

Let us see how to use this fantastic technique in the stock market to predict price movements.

Did You know?

In 2005, an inexperienced trader at a Japanese bank attempted to sell One J-Com share for 640,000 YEN. He accidentally sold 640,000 shares of J-Com for One YEN apiece, which is the equivalent of selling \$3 billion worth of stock for \$5,000.

1) Fibonacci retracement

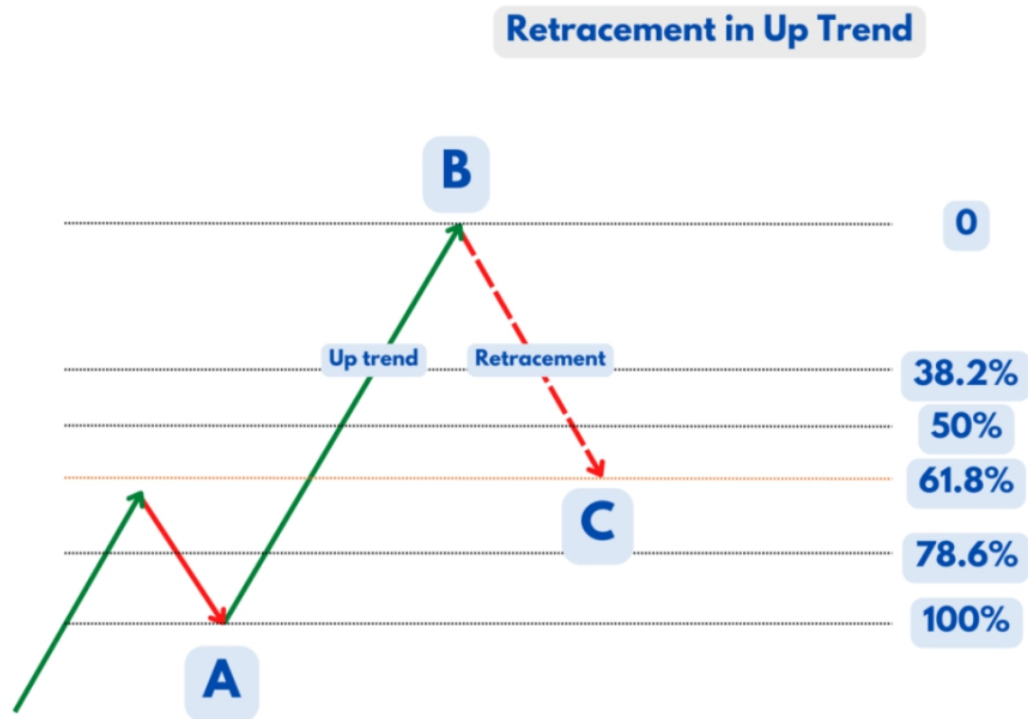


Figure 3.1.1

Traders use the Fibonacci retracement tool to predict or forecast the possible price movement when a powerful upward or downward trend takes a direction change. Take an uptrend as an example. When the direction of the uptrend changes to a downtrend before going back up, this is called a retracement .

When a direction change happens, plotting Fibonacci retracement will give the traders some idea about the next possible price movement, i.e., 38.2%, 50%, 61.8%, 78.6%, and 100%. Even though 50% is not a Fibonacci number, traders use it as a key level when using technical analysis. Most of

the top-trading stocks, currencies, and commodities obey the Fibonacci levels to a great extent.

Taking two extreme points on a chart and dividing the distance between them by important Fibonacci ratios gives a Fibonacci retracement forecast. 0% is the start of the retracement, while 100% is a complete reversal of the original price before the move. Horizontal lines are drawn in the chart for these price levels to provide support and resistance. The common levels are 23.6%, 38.2%, 50%, 61.8%, 78.6%, and 100%.

In the above figure, we moved the price from point A to point B. The forecast of price movement to point C can be created by connecting point A and point B (swing low to swing high) using the Fibonacci retracement tool. Then it will show the retracement levels to point C, which will act as the possible future target. Intelligent traders use this highly effective tool to predict price movement and other patterns. Once the retracement begins, they will start selling and riding the profits while observing the Fibonacci levels.

Rule of thumb:

1. The majority of ordinary traders use Fibonacci retracement for price forecasts. But most trades hit a stop-loss or result in a significant loss.
2. The problem here is that one cannot predict up to which level the retracement will happen (23.6%, 38.2%, 50%, 61.8%, or 78.6%).
3. So, the practical solution to this problem is to do a **Character analysis** of the stock, currency, or commodity.
4. Most traders know about the Fibonacci tool but use it the wrong way and lose. On the other hand, intelligent traders understand and use the tool efficiently to bag profits.

Character analysis

Just like humans, the price movement of every stock, currency, or commodity has some characteristic behavior. So, observing the past performance of a financial asset eases the process of understanding its character and, to some extent, helps to predict its future price movement in the market. Therefore, it is necessary to look into that asset's historical charts and analyse how it behaved in the past. Then, using the Fibonacci tools, investors can check past price movements and identify which Fibonacci level the asset follows.

.For example, consider a company named XYZ.

By the historical chart analysis, it is found that:

- XYZ stock has followed 61.8% Fibonacci levels 65% of the time
- XYZ stock has followed 78.6% Fibonacci levels 8% of the time.
- XYZ stock has followed 23.6% Fibonacci levels 10% of the time
- XYZ stock has followed 50% Fibonacci levels 7% of the time.
- XYZ stock has followed 38.2% Fibonacci levels 10% of the time.

This means that:

1. 90% of the time, the XYZ stock is retracing up to 38.2% Fibonacci levels.
2. 80% of the time, the XYZ stock is retracing up to 50% Fibonacci levels.

3. 73% of the time, the XYZ stock is retracing up to 61.8% Fibonacci levels.

Keeping this information in mind, one can use the Fibonacci retracement tool to predict future price movement, increase the probability of winning trades, and trade more confidently. It's effortless. Right?

These are some of the unique secrets the smart traders use to outsmart the other majority of traders. They usually don't share their secrets with anyone. That is why this is the least discussed topic even on the internet.

Fibonacci retracement (Uptrend)

XAU/USD Daily Chart

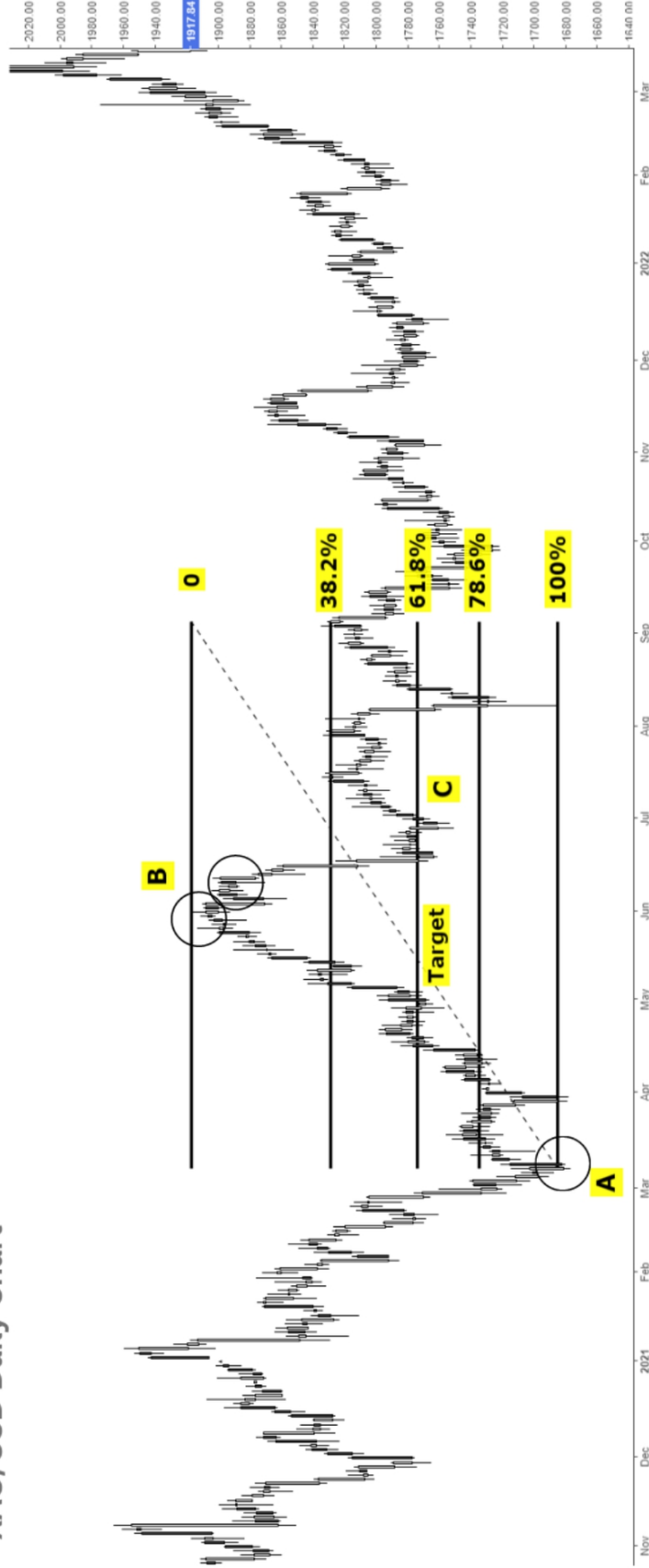


Figure 3.1.2

The daily price chart of gold spot/US dollar is shown in Figure 3.1.2.

- The figure shows the retracement of the price movement from point A to point B.
- The price moved upward from point A to point B and then retraced to the future price point C.
- Using the Fibonacci tool, the first price point A is connected to point B to get the retracement levels.
- Here the price touched the critical golden ratio of 61.8% (point C) and bounced back from that level.

Retracement in Down Trend

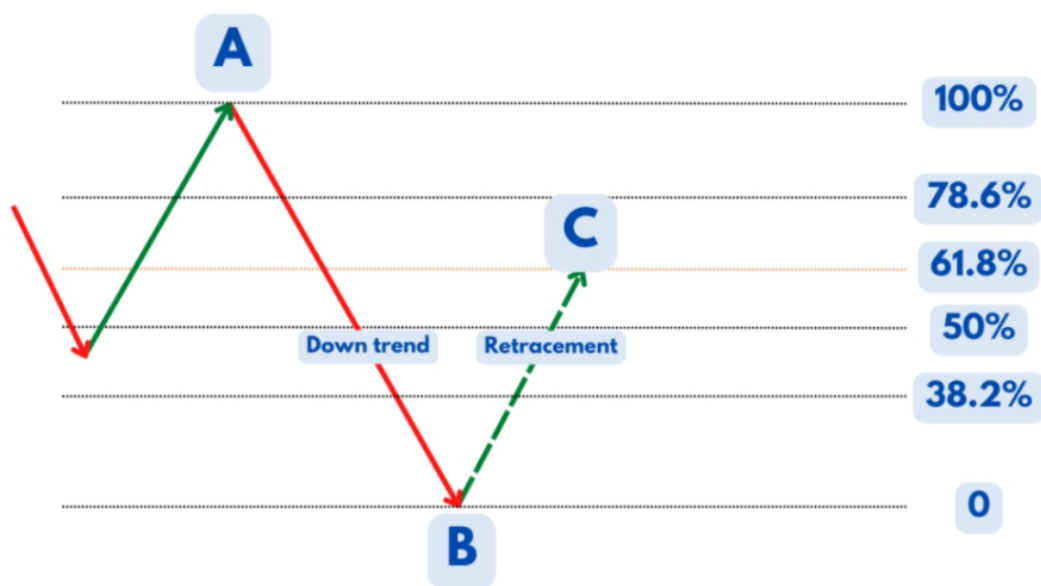


Figure 3.1.3

The above chart shows a Fibonacci retracement in the downtrend. Here, the price was falling and took a U-turn. In such a scenario, use the tool to create a Fibonacci retracement from point A to point B (swing high to swing low). Then it will plot the possible Fibonacci retracement levels to which the price may increase. Once the retracement begins, traders usually go to buy the asset.

Fibonacci retracement (Downtrend)

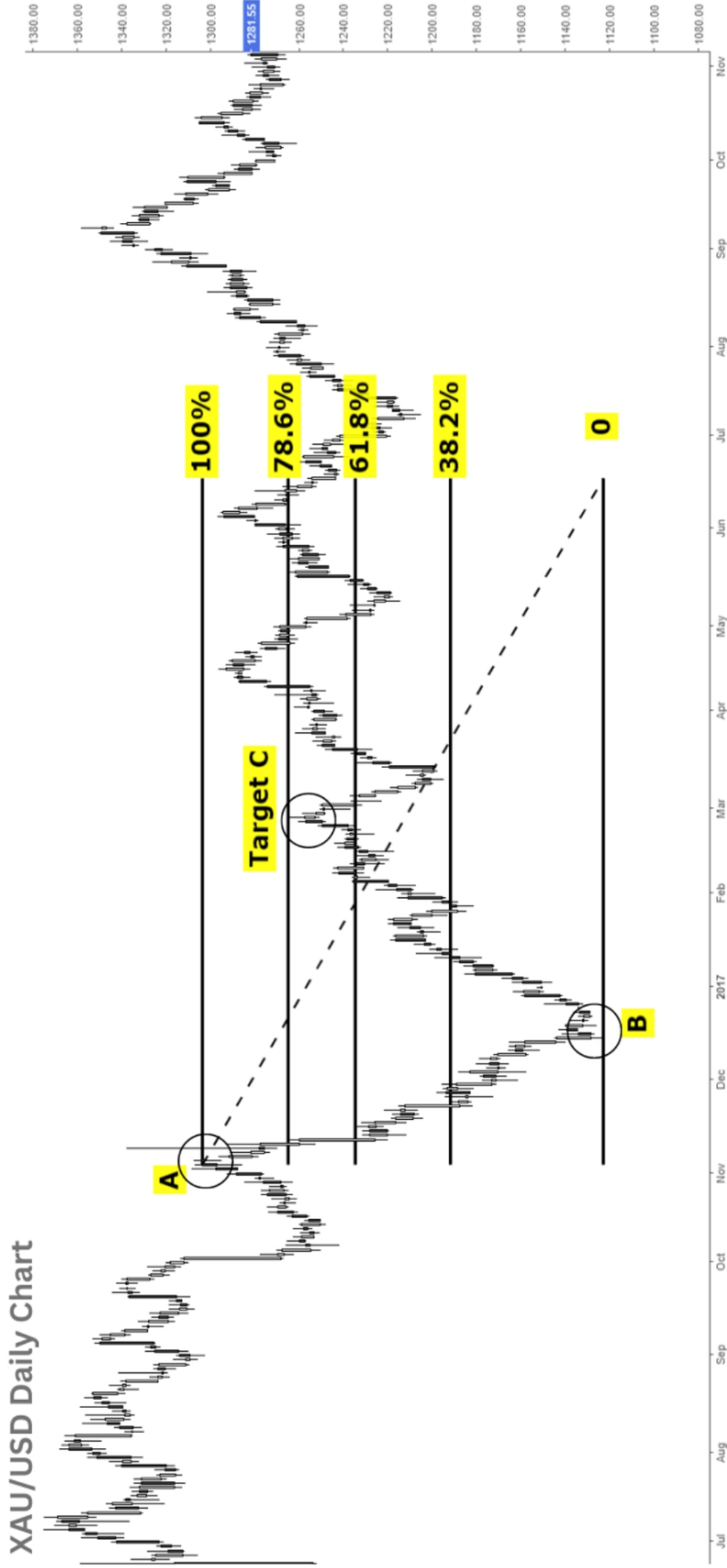


Figure 3.1.4

The daily price chart of gold spot/US dollar is shown in Figure 3.1.4.

- The figure shows the Fibonacci retracement for price movement in a downward direction.
- Here the price moved downward from point A to point B and took a U-turn to retrace to point C.
- By using the Fibonacci tool to connect points A and B, the price retracement to the future price point C can be found.
- The chart clearly shows that the price retracement touched the Fibonacci levels of 61.8% and 71.6% (point C), respectively.

2) Fibonacci Extension

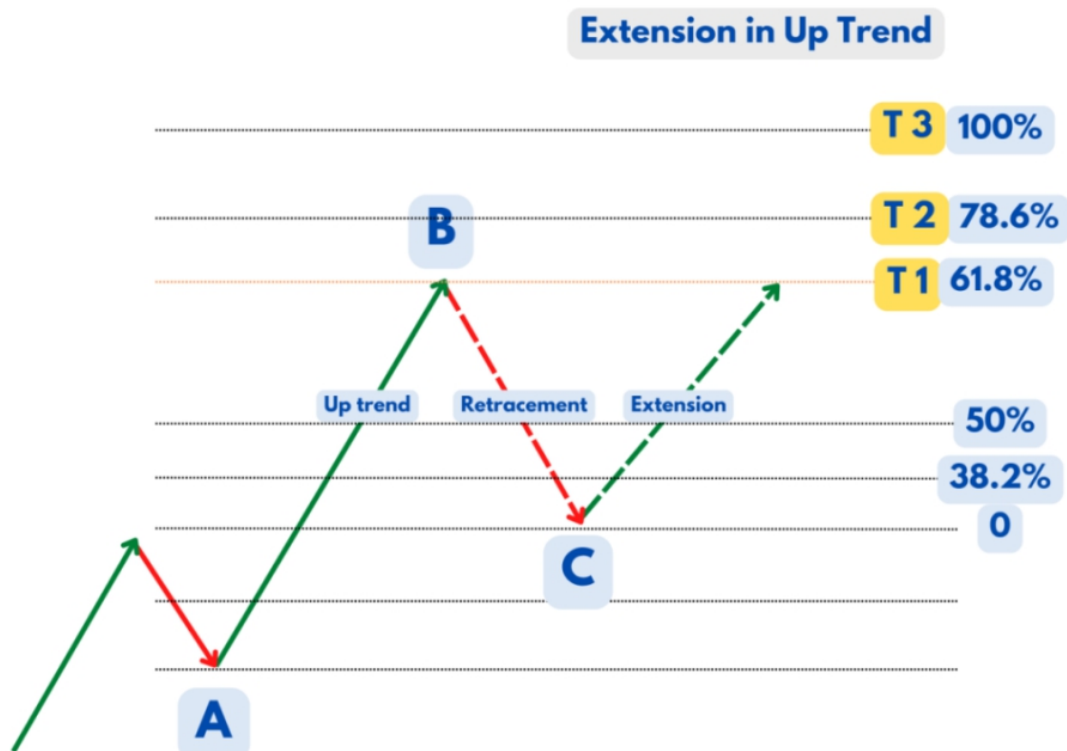


Figure 3.2.1

A Fibonacci extension is a useful tool that traders use to estimate where a price might go after a pullback or to find possible profit targets. There is also a possibility that the price will reverse at extension levels. Like Fibonacci retracement, Fibonacci extension levels are also based on Fibonacci ratios (as percentages). Fibonacci extension levels that are commonly used are 61.8%, 78.6%, 100%, 161.8%, 200%, and so on.

The above figure shows the movement of the price from point A to point B (swing low to swing high). Then, it is retraced back to point C. Plotting these 3 points using the Fibonacci extension tool will show the following levels to which the price would move: 61.8%, 100%, 161.8%, etc.

Fibonacci Extension(Uptrend)

USD/CHF Daily Chart

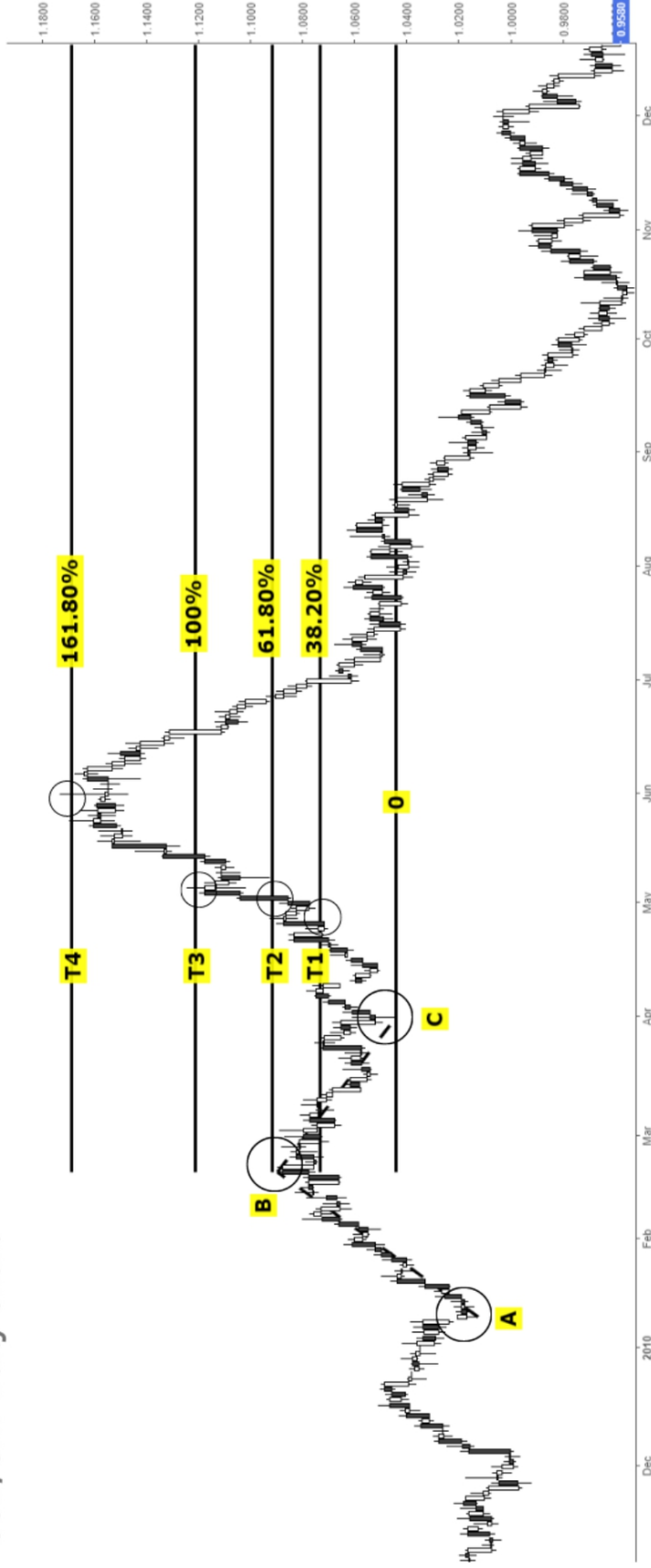


Figure 3.2.2

Figure 3.2.2 shows the daily price chart of the US dollar against the Swiss franc.

- Here, consider the upward price movement from point A to point B, which then retraces to point C.
- Plot the Fibonacci Extension tool on the price chart, starting from point A, going to point B, and then to point C to get possible future targets T1, T2, T3, and T4.
- The chart clearly shows the price movement hitting the target levels T1, T2, T3, and T4.

Did You Know

The Amsterdam Stock Exchange, founded in 1602, is the world's oldest stock market. The Dutch East India Company founded it and sold printed stocks and bonds.

Extension in Down Trend

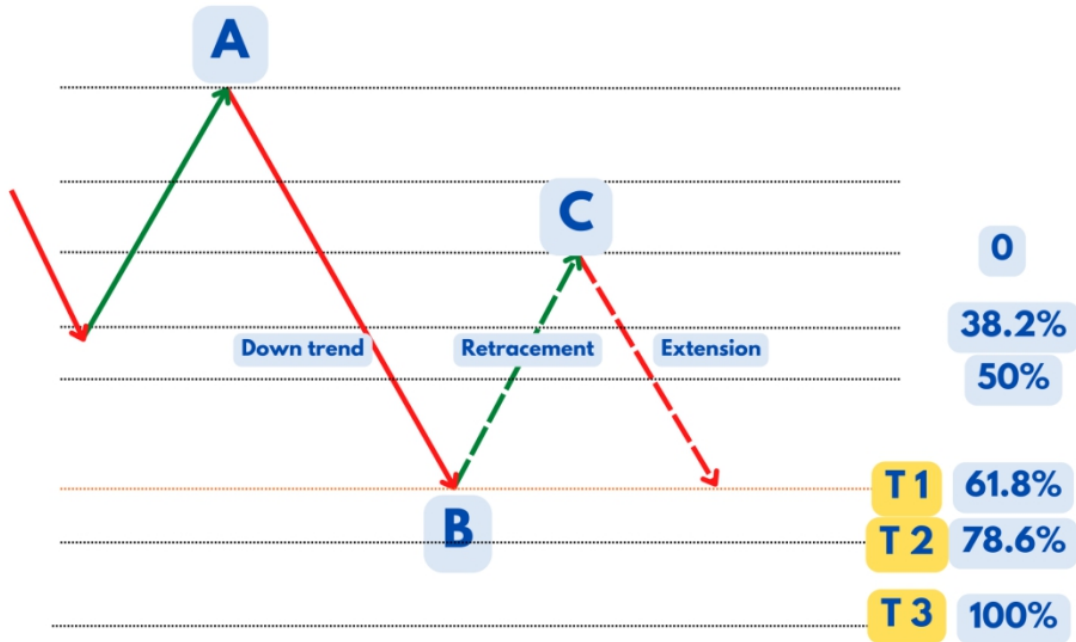


Figure 3.2.3

In a downtrend, using the Fibonacci extension tool, connect points A (high) to B (low) and then C (retracement). This tool will plot the possible target levels and give the trader an idea of up to which levels the price will move next.

How does Fibonacci extension differ from Fibonacci retracement?

Fibonacci retracements measure the pullbacks within a trend. In contrast, Fibonacci extensions measure the impulse waves within the trend direction. Fibonacci retracement levels indicate how deep a retracement might be. At the same time, extensions show where the price will go following a retracement.

Fibonacci Extension(Downtrend)

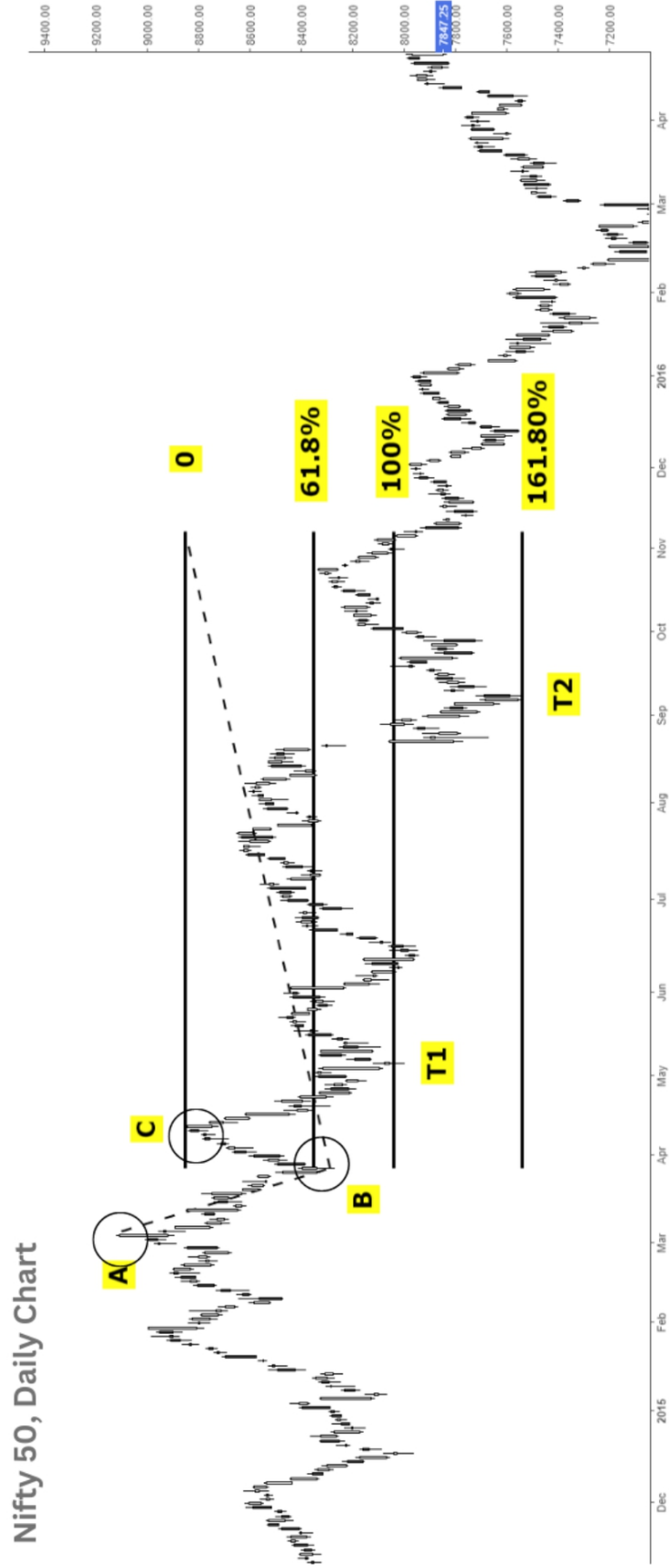


Figure 3.2.4

Figure 3.2.4 shows the daily chart of the Nifty 50 Index, NSE.

- Here, consider the downward price movement from point A to point B, which then retraced to point C.
- Following the steps previously used in Figure 3.2.3, plot the Fibonacci Extension tool on the price chart, starting from point A to point B and then to point C. The Fibonacci Extension Tool will show the possible future targets T1 and T2.
- The chart clearly shows the price movement hitting the target levels T1 and T2 in the downward direction.

Chapter IV

Indicators

In technical analysis, a technical indicator is a calculator that uses historic price, volume, and open interest information to predict the direction of a financial market. The market constantly switches between bullish and bearish modes. Moreover, the strength and duration of the trend (uptrend and downtrend) also change with time. Here, technical indicators can be of great help.

There are four types of technical indicators: trend indicators, momentum indicators, volume indicators, and volatility indicators.

Here we will discuss trend and momentum indicators.

Trend indicators:

- *Trend indicators* measure trend direction.

These indicators also help find out the strength of a particular trend. One of the most commonly used trend indicators is the moving average.

Moving average (MA)

The average of the prices at the end of the most recent few trading sessions serves as a moving average, which is a trend indicator. The moving average makes an average price line that is always up to date and smooths out price data over time. By drawing a single, flat line on a chart of prices, a moving average gets rid of the effects of random price changes. Traders take the average of several periods, such as ten days, 20 minutes, 30 weeks, or any period they choose. Among the most popular simple moving averages for investors and trend followers are the 200-day, 100-day, and 50-day moving averages. The angle of movement of moving averages shows whether the price movement is trending or ranging. The horizontal direction of the moving average shows that the price is ranging or in consolidation. If the moving average is moving upward, it shows an uptrend. But it doesn't

mean that the price will go up. Instead, it shows an overall picture of the trend direction based on the previous price movements.

Trade Setup using the Moving Average

1. Plot the two moving averages, 50 days and 200 days, on the same price chart.
2. When the two moving averages cross each other, it indicates an opportunity to buy or sell.
3. A Buy signal is formed when the 50-day moving average exceeds the 200-day moving average.
4. A Sell signal is formed when the 200-day moving average exceeds the 50-day moving average.

Moving Average(Uptrend)

XAU/USD Daily Chart

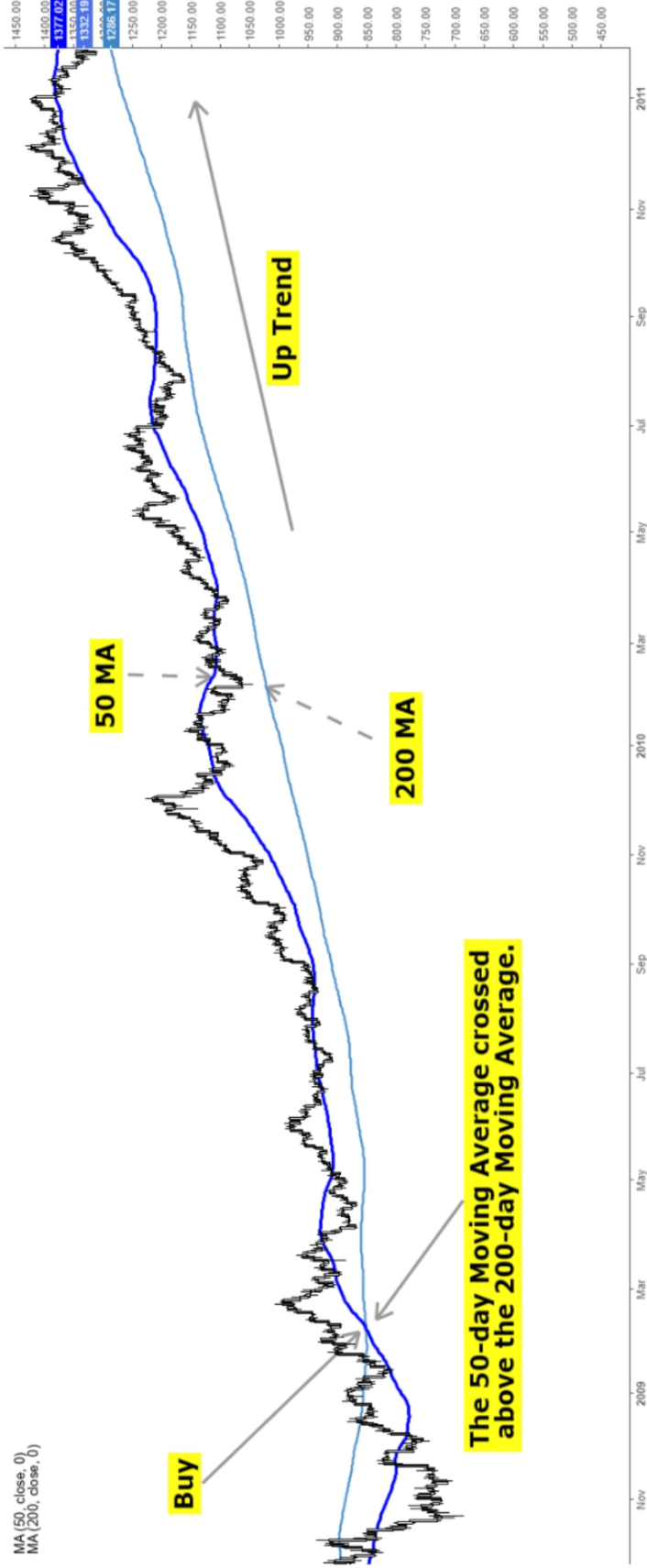


Figure 4.1.1

The daily chart of the gold spot/US dollar rate is shown in Figure 4.1.1.

- Here, 50-Day Moving Averages and 200-Day Moving Averages are plotted on the price chart.
- The upper blue line shows the 50-day MA, and the lower red line shows the 200-day MA.
- When the price changed from the lowest point to Higher High (HH), the 50-day moving average exceeded the 200-day moving average.
- This indicates price movement in an upward direction.
- As seen in the figure, the price continued to move in the uptrend for some time, with 50 Day MA still above 200 Day MA.

Moving Average(Downtrend)

XAU/USD Daily Chart

MA (50, close, 0)
MA (200, close, 0)

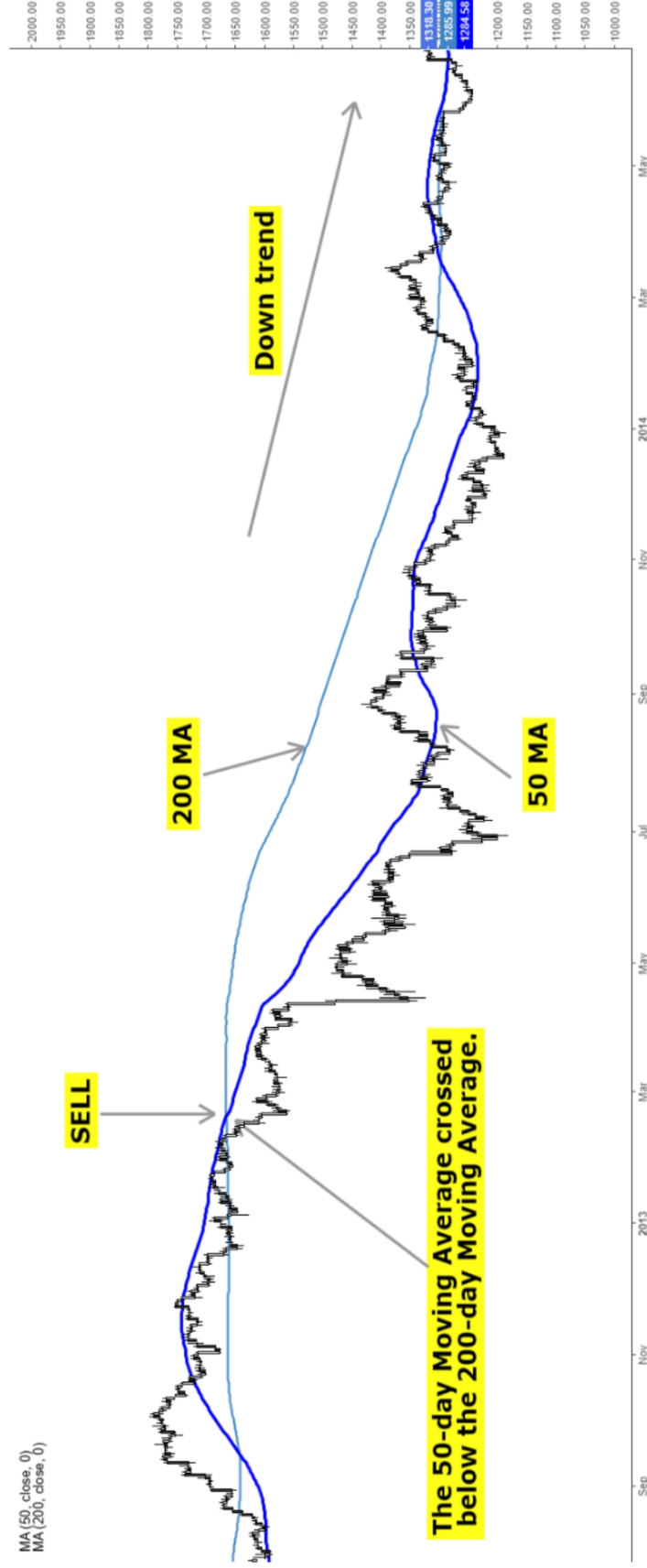


Figure 4.1.2

The daily chart of the gold spot/US dollar rate is shown in Figure 4.1.2.

- As in Figure 4.1, the 50-Day Moving Averages and 200-Day Moving Averages are plotted on the price chart.
- When the price changed from the highest point to Lower High(LH), the 50-day moving average crossed below the 200-day moving average.
- This indicates price movement in a downward direction.
- The chart/information graph indicates that the price continued to move in the downtrend for some time, with the 50-day MA line below the 200-day MA line.

Did You know?

In the month of September, the market had the worst performance on average. During September, the Dow has been down 1.1%, and the S&P 500 has dropped 0.7% on average since 1950. Since its inception in 1971, the Nasdaq Composite Index has lost an average of 1% in September.

Momentum indicators:

The momentum indicators are technical analysis tools that determine how reasonable or weak a stock's price is. The momentum indicators measure the rate at which stock prices rise or fall. One of the most commonly used momentum indicators is the Relative Strength Index.

Relative Strength Index (RSI).

The relative strength index (RSI) is a technical indicator that looks at how fast prices change and how much they change. J. Welles Wilder developed it in 1978. When plotted on a price chart, RSI assigns stocks a value between 0 and 100. The RSI levels oscillate between zero and 100. The RSI indicator has two warning levels to indicate overselling and overbuying. Levels 70 and 30 are standard levels that serve as a warning system for overbought and oversold assets.

Trade setup using RSI

1. Plot a 14-day RSI on any price chart. [RSI(14)]
2. When the RSI is above 70, the stock is considered overbought, so the price could start falling.
3. When the RSI is below 30, the stock price is considered oversold, which paves the way for a bullish price movement at any time.
4. For better results, use the 14-day RSI along with the 50-day moving average and the 200-day moving average.

Moving Average with RSI

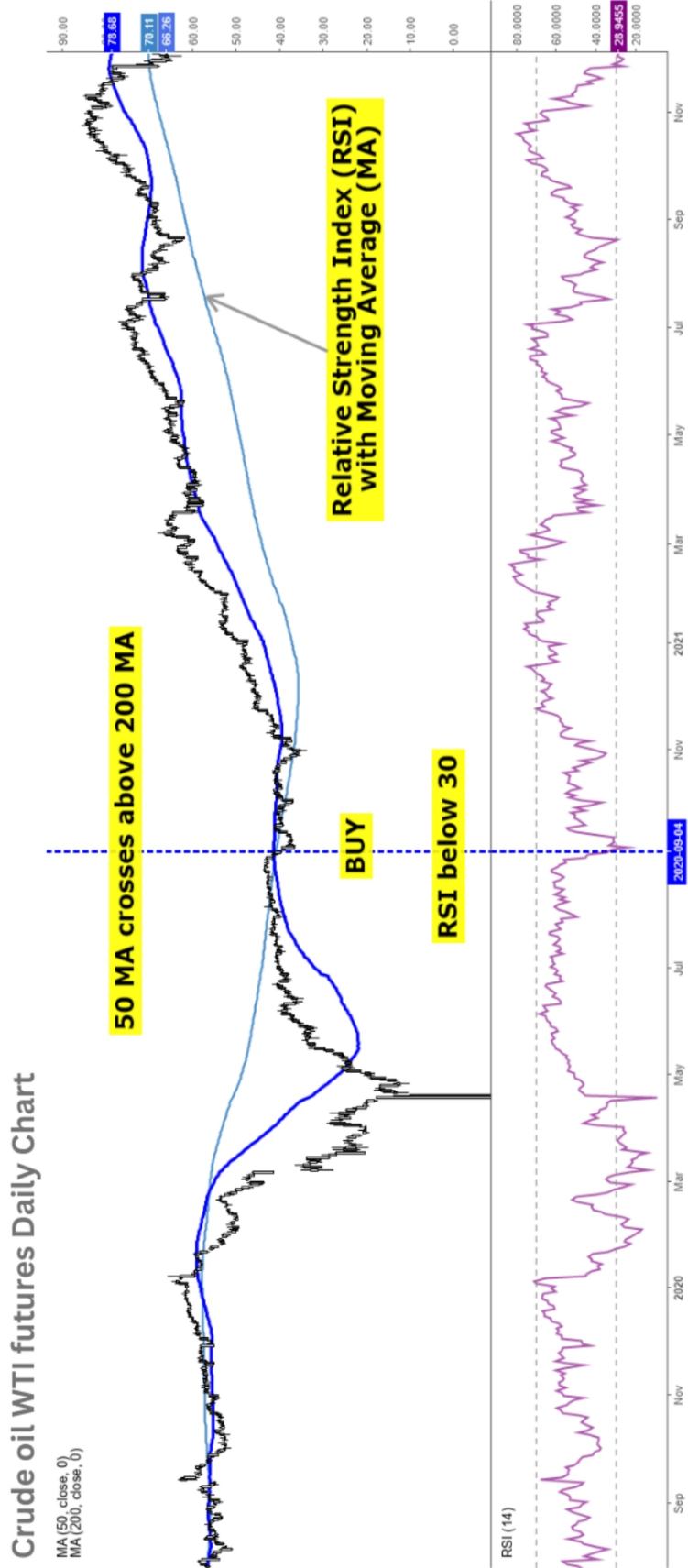


Figure 4.2.1

Figure 4.2.1 shows the daily price chart of WTI Crude oil.

- Here the indicator's 14-day RSI, 50-Day Moving Average, and 200-Day Moving Average are plotted on the price chart.
- In the beginning, the RSI was lower, but the 50-day moving average was below the 200-day moving average.
- The figure shows that the 50-day moving average exceeds the 200-day moving average. At the same time, RSI was at 27 levels.
- This indicates strong price movement in an upward direction.
- The price continued to move in the uptrend for some more time, with the 50-day MA still above the 200-day MA.

How effective is pattern trading?

People always have a question in mind about the effectiveness of pattern trading. For example, some may wonder how often a pattern appears in a chart or if it takes longer for a pattern to complete so that they can enter a trade.

The exciting thing is that some pattern formation exists in different time frames if you take any price chart.

For example, if you take the price chart of XYZ company, you could find a pattern formed in the monthly time frame. When you switch to the weekly timeframe of the same chart, you will find another pattern. The same happens with the daily 4 hour, 1 hour, 15 minute, and 5 minute charts of the same company.

There also exist the possibilities of multiple pattern formations in the same time frame of the price chart.

Multiple chart patterns

USD/INR Daily Chart

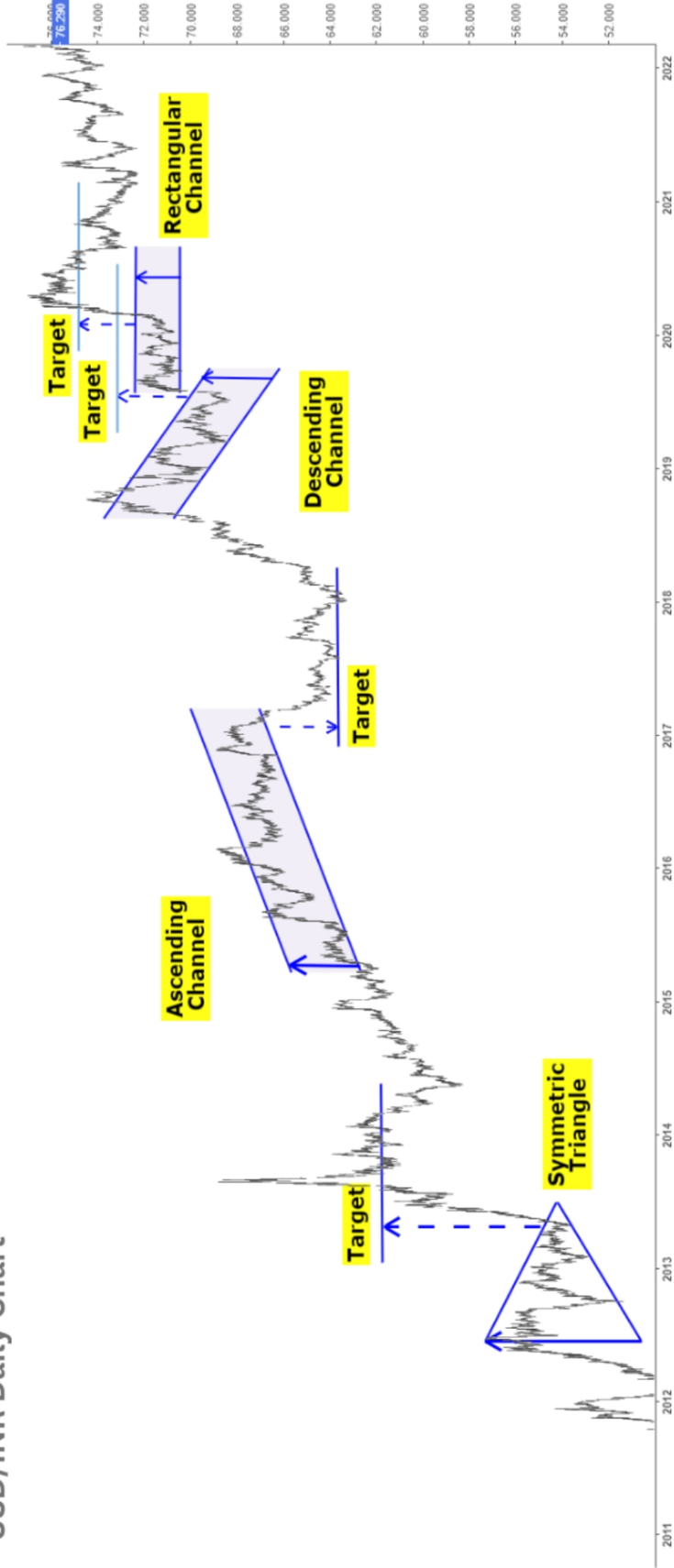


Figure 4.2.2

Figure 4.2.2 shows the forex daily price chart of the USD/INR.

- The data show that multiple patterns have formed in the USD/INR price chart on a daily timescale.
- First, a symmetric triangle is formed, followed by one ascending channel and two descending channels.
- All four price patterns hit the target level per the pattern trading rules.
- The trades that were based on four pattern formations (three buy signals and one sell signal) did very well. If analysed further, one can identify more patterns in the same chart with different time frames.

Did You Know?

On May 22, 2010, a programmer named Laszlo Hanyecz in Florida, USA, traded 10000 bitcoins in his account for two large-sized pizzas, valued at around \$41 back then. In 2021, those bitcoins would be worth about 640 million US dollars. May 22 is now famously known as "Bitcoin Pizza Day."

Chapter V

Trade Discipline

A funny story about trading

There was a professional trainer who trained hundreds of people to trade in the financial markets. He had a set of new traders who were getting started in trading.

The trainer taught them all the basics, how to do fundamental and technical analysis, and all the new tools needed for trading. He demonstrates specific trading strategies and tells them what they should and shouldn't do.

But unfortunately, this trainer couldn't seem to get his traders to make money. The traders tried everything they could but still lost money in the markets. The trainer was also frustrated because of the trader's failures.

So one day, he got an idea and devised a strategy to assist his traders in becoming more profitable. He invented a ground-breaking new method of training them. He instructed them to make three trades. And they have to do something wild with these three trades. Instead of seeking ways to make money, they must lose money on all three trades in a row.

That means they'll have to lose money on trade 1, trade 2, and trade 3. The idea seemed simple, but the traders couldn't even get it right this time! **The majority of those trades ended up in profits!**

So here is the moral of the story:

You should consider changing your trading strategy if you're doing everything right but it isn't making you money in the long run.

Why not try it the other way around?

We have now arrived at the most critical chapter of this book, which is:
“Trade discipline.”

Trading in financial markets is truly a mind game. Only sharp and strong-minded traders can survive longer with consistent profits. One can master this skill through constant learning and practice. There are a few book recommendations for the readers that I have given at the end of this chapter that helped me succeed in my trading more than any tool or strategy. These books are easy to read and will assist you in making investment decisions and other areas of your life.

Did You Know?

While London may appear to be the largest stock exchange centre, the New York Stock Exchange (NYSE) is the largest, with \$1,452 billion in monthly trade volume. Shanghai is the second-largest stock exchange. The Shanghai Stock Exchange deals with \$536 billion. Each month, the London Stock Exchange Group trades only \$219 billion.

We have learned about various trading methods using patterns, Fibonacci, and indicators.

Now here comes the exciting part:

What if I told you you could profit from trading without using tools or strategies?

Yes. It is possible!

The secret lies in **trade discipline**.

Whatever the market condition, you can make money quickly with a good trading discipline, which is more important than any tools or strategies.

To have trading discipline, you need to follow two things.

They are:

- 1. Position sizing**
- 2. Risk Reward Ratio**

1) Position sizing

90% of traders fail because they have no trading discipline. These traders know how to trade but do not know how many shares or commodities to buy or sell per trade. Instead, they trade with all their capital in their trading account, which is not right. In addition, they do not know anything about position sizing.

The position sizing strategy has only one thumb rule:

"Do not risk more than 1% of your capital in any single trade."

Three factors determine how much to buy or sell in a particular trade:

1. The capital you have for trading
2. The risk per share or commodity you are willing to take (share price – stop loss)
3. Cost of the stock or commodity

For example:

You have a capital of \$100,000 in your trading account. The following table will show the ideal position size according to the amount of risk the trader is willing to take.

Capital in Trading account	100,000
1% of Capital (Maximum risk per trade)	1000
The stock price	100
Stop Loss	95
Maximum risk per share	5

The ideal trading quantity

= Maximum Risk you take in a trade / Maximum risk per share

= $1000/5 = 200$ shares.

In this trade setup, if anything goes wrong and your stop-loss hits, all you can lose is 1% of your capital, which is 1000\$.

Here you have the capital to enter 100 different trades, meaning you must be wrong in 100 trades to lose all your money in your trading account. I am sure that that's very unlikely .

Note: Many traders find that the 1% rule doesn't work for them because they only have a small amount of money to trade with. These traders usually take more risks per trade, like 5%, 10%, or even more, because they find it hard to trade with smaller lots. They risk losing their entire investment with fewer trades.

For a successful trade setup, traders must use a position sizing strategy and a Risk Reward Ratio.

In the above example,

- Suppose you use the position sizing strategy correctly and a Risk reward ratio of 1:3. In that case,

- Even if you lose 70 trades out of 100 trades, you will still be in profit with just 30 winning trades.

To understand it better, let's learn about the Risk Reward Ratio.

Did You Know?

The New York Stock Exchange is the most traditional stock exchange, with traders required to wear a suit and tie to enter the exchange's trading floor.

2) Risk Reward Ratio

The risk-reward ratio is a measure of return in terms of risk for a specific period. Using this ratio, you can estimate the expected return per unit of risk on a trade.

Investors and traders follow the risk-reward ratio to protect their capital. Trades and investors with excellent trading discipline follow the risk-reward ratio to generate consistent profits. There are different risk-reward ratios for a trader to choose from. The most commonly used ratios are 1:1.5, 1:2, and 1:3.

Successful traders do the following while using the risk-reward ratio:

1. Choose the risk and reward level according to their strategy.
2. A risk-to-reward ratio of over 1.0 indicates greater potential risk than potential reward; anything below 1.0 suggests that the potential profit is greater than the potential risk.
3. The higher the reward, the longer the trade duration.
4. No matter what happens in trades, never square off positions before reaching profit or loss positions defined by the selected risk-reward ratio.

Risk Reward (1 : 1.5)

Win	Profit/trade	Total	Loss	Loss/Trade	Total	Net Profit/Loss
6	1500	9000	4	-1000	-4000	5000
4	1500	6000	6	-1000	-6000	0
3	1500	4500	7	-1000	-7000	-2500

Risk = 1000 Reward = 1500 Total Trades = 10

Here, the trader decides to take the risk of 1 for a return of 1.5.

Risk = 1000 for a reward of 1500.

Let us see what happens if the trader wins four trades and loses six trades.

- **Win : 4 x 1500 = 6000**
- **Loss : 6 x 1000 = 6000**
- **Gain – Loss = 0**

In this setup, even if the trader loses six out of 10 trades and succeeds in only four of the trades, the net profit or loss is zero.

With this risk-reward ratio, your capital is safe even if you lose 60% of your total trades.

Risk Reward (1 : 2)

Win	Profit/trade	Total	Loss	Loss/Trade	Total	Net Profit/Loss
6	2000	12000	4	-1000	-4000	8000
4	2000	8000	6	-1000	-6000	2000
3	2000	6000	7	-1000	-7000	-1000

Risk = 1000 Reward = 2000 Total Trades = 10

Here,

the trader decides to take the risk of 1 for a return of 2.

Risk = 1000 for a reward of 2000.

Let us see what happens if the trader wins three trades and loses seven trades.

- **Win : 3 x 2000 = 6000**
- **Loss : 7 x 1000 = 7000**
- **Gain – Loss = -1000**

In this setup, even if the trader loses seven out of ten trades and succeeds in only three trades, the net loss is the risk amount, i.e., \$1,000.

This means that with this risk-reward ratio, **even if you lose 60% of your total trades, you can still end up with a profit.** If you lose 70% of your total trades, your losses will be marginal.

Risk Reward (1 : 3)

Win	Profit/trade	Total	Loss	Loss/Trade	Total	Net Profit/Loss
6	3000	18000	4	-1000	-4000	14000
4	3000	12000	6	-1000	-6000	6000
3	3000	9000	7	-1000	-7000	2000

Risk = 1000 Reward = 3000 Total Trades = 10

Here, the trader decides to take the risk of 1 for a return of 2.

Risk = 1000 for a reward of 2000.

Let us see what happens if the trader wins three trades and loses seven trades.

- Win : $3 \times 3000 = 9000$
- Loss : $7 \times 1000 = 7000$
- Gain – Loss = +2000

In this setup, even if the trader loses seven out of 10 trades and succeeds in only three, the net profit is 2000.

This means that with this risk-reward ratio, **even if you lose 70% of your total trades, you can still profit.**

Heads or tails?



Are you ready to play a game to test the success rate of the risk-reward ratio?

If the answer is YES!!, then read the following:

Disclaimer :

Here, the writer suggests making artificial trades strictly for educational purposes to test the success rate of the risk-reward ratio. (**NOT ON REAL-MONEY TRANSACTIONS.**)

Things you will need:

- A mock, dummy, or artificial trading account (if you don't have one, do paper trading, making imaginary trades with the real-time price of stocks, currencies, or commodities).
- A coin
- A book and a pen to write the results.

The steps are as follows:

1. Select a risk-reward ratio (1:2 or 1:3, etc.).
2. Flip the coin.
3. Go for an immediate BUY in the dummy trading account if you get heads.
4. And, if you get tails, go for a SELL.
5. Make at least ten trades (the more the number of trades, the better), with strict stop losses and targets set according to the selected risk-reward ratio.
6. Evaluate the results and calculate the overall profit or loss.

The results will be surprising.

Even if 60% of executed trades result in losses, overall trades result in profits.

This experiment shows one does not need all the knowledge to become a successful trader. In other words, a trader requires a good risk-reward ratio, trade discipline, and just a coin to succeed. In addition, the winning chances and profits of trades improve with the use of technical analysis such as pattern trading, Fibonacci, and indicators .

Now here is the frequently asked question:

If this strategy is so successful, what is the need for technical analysis?

Answer : There are three conditions in a financial market: upward movement, downward movement, and sideways movement. This strategy works well when the market is in an active state, when there is a strong upward or downward movement, resulting in better profits. But suppose the

market goes sideways, almost like a dormant state. In that case, the profits will be lower as the price may not reach the targets per the calculated risk-reward ratio. In that case, one can use technical analysis to determine whether a sudden movement is expected in the market.

How to Win at the Stock Market: Mental Muscle-Building Books to Sharpen Your Mind

The stock market is an arena of warriors. The only way to survive there, if you want to play long-term, is to be mentally prepared for any situation that might come up. The world of finance can be unpredictable, so you need to be ready to face whatever comes your way to win the game. You need to build mental muscles and sharpen your mind to do this. The good news is that books are a great tool that can help you achieve this goal.

Books to Sharpen Your Mind

Reading can improve your memory. By reading, you improve your ability to remember things. The more you read, the better your brain will retain and recall information accurately in various situations.

1) The Power of Your Subconscious Mind: by Joseph Murphy

The most important part of your life and business is not what you do but what you think. You can change your life by changing how you feel. This book will help you learn how to master your subconscious mind. It will teach you how to use it for success in every area of your life, from health and wealth to relationships and happiness. By learning about thought patterns that have been successful for others, you can create a positive pattern for yourself. This book is excellent for anyone who wants to improve their quality of life or advance in their career!

2) Rich Dad, Poor Dad, by Robert Kiyosaki

This book is by far my favourite personal finance book of all time. The author, Robert Kiyosaki, argues that money isn't a finite resource. As a result, this book will have you thinking about finances utterly differently from every other book out there. It will help you focus on what matters—

assets and liabilities—rather than just income or assets themselves. In short, if you want to be prosperous, read Rich Dad, Poor Dad!

3) The Psychology of Money, by Morgan Housel

Here's why people make bad financial decisions—and how to avoid those mistakes. People don't buy things because they need them but because they want them. It doesn't matter if you want a Ferrari or a 12,000-square-foot mansion on a private beach; that decision requires careful consideration from an objective standpoint, not an emotional one. This book is easy and quick for anyone interested in becoming better at money management.

4) The Richest Man in Babylon, by George Samuel Clason

This is a classic book for wealth-building and financial success. Every aspect of your finances will be laid out before you. This book provides helpful guidance in each stage of financial independence and freedom, from living paycheck to paycheck to finally being in retirement. It will teach you how to save money, protect that investment, build credit scores, and leverage it wisely. It will help you set a budget for each week of the year so that spending doesn't get out of control.

5) The 5 AM Club, by Robin Sharma

If you want to be successful in the stock market, you need to have a sharp mind. But it would be best to build your mental muscles to sharpen your mind. The 5 AM Club is a great book to help you do that. This book is about developing a revolutionary morning routine to maximise productivity, prosperity, and serenity. I highly recommend it to anyone looking to improve their mind and life.

Conclusion

It is a universal truth that everything in this world, including our lives, circumstances, situations, and even our future, is uncertain. One cannot predict what will or will not happen next, and the stock market works the same. It is impossible to predict precisely which way the price will go. Sometimes, even when all the patterns and indicators clearly show one direction for the market, it goes the opposite way. Situations like war, pandemics, disasters, government policies, a conflict between countries, etc., could scare investors and create chaos in the market.

These rare situations do not occur every time. But it could cause enormous losses to ordinary traders and investors. On the other hand, many traders with good trade discipline and money management skills profit significantly from these uncertain situations. Every trader in the market, whether a small or prominent institutional trader, is susceptible to these situations. No one has control of the financial market. This is because the financial market, a wonderful creation of human beings, operates on two human emotions: **fear and desire**.

All humans have a fear of losing everything and a desire to gain everything. Both, in the extreme, are destructive emotions.

We can succeed in the long run if we accept these facts and move ahead with conscious decisions and trade discipline.

Did You Know?

Ronald Wayne was the third co-founder of Apple, along with Steve Wozniak and Steve Jobs. In 1976, he sold his 10% stake in the company for \$800. Today, his 10% would've been valued at nearly \$35 billion.

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