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LESSON 1: FUNDAMENTALS OF FOREX

WHAT ARE THE FOREX MARKETS?

What you will learn this chapter:

- How much the FX markets are worth
- Why we trade in pairs
- Technical FX trading
- Fundamental FX trading

The FX, Forex or Foreign exchange markets are the most liquid in the world. It is estimated on average between \$4-5 trillion are traded every day. When referring to the currency markets the general market term is 'FX.' It can be referred to as 'Forex & Foreign exchange' essentially it is all the same thing. It is important to learn the language and terminology in trading. Market commentators and analysts always use the correct trading terminology, so you do not want to miss important information.

We can all understand the basic concept of currency. A country will issue its own currency in order to allow people to buy and sell goods and services. The perceived strength of a country's economy is usually reflected in its currency rate. So, a country with a strong currency, in economic terms, is seen to be economically sound.

When you put the term 'trading' with currency however, things can get a lot more complicated. It does not have to be, but the markets and its terminology are designed to be intimidating and stop ordinary people from being involved. By the end of this book you should see that it is not as complex, but the experts would like you to believe it is.

However, when you put the term "exchange" on the currency, things can get much more complicated.

SO WHY THE FOREIGN EXCHANGE MARKET?

Let us take a closer look at what this market is and why it is so fascinating to novice and professional traders alike!

- Trade 24 hours a day
- High Liquidity
- Long/Short operations
- Easy to understand, unlike options and futures or the market which is usually much more complicated.
- No commissions or tight margins
- Leverage. This means that you are putting in a small amount of capital, but it allows you to trade for a much larger position. The size of the position will depend on how large the leverage is. You only put in a fraction of your total initial capital, exactly because of the leverage we discussed earlier.

The foreign exchange market is an over the counter (OTC) market.

LONG VS SHORT OR BUY VS SELL

- Long is a term used to indicate that we are buying the pair.
- Short simply means that we are selling something that we have not bought before
- We can successfully trade by buying or selling a rate!
- Selling an exchange rate in the short term means that we simply make money on the way down.

Remember: your goal is to be profitable, not to prove you are right.

FX is not about keeping the currency in its physical form - whether you buy or sell a currency depends on your view of the market! You can argue this any way you want, but with commodities such as oil and gold priced in dollars and most countries' reserves being in U.S. dollars, it is hard to argue against this.

It is estimated that there are 1.39 trillion dollars in circulation by the Federal Reserve. In commercial terms the dollar is king. Most of the major currency pairs that traders, banks, and institutions favor are those that include the Dollar. After all, it is the largest consumer nation on earth and is often seen as a haven in times of market turbulence.

Why are currencies always traded in "pairs"? When trading in the currency markets you cannot simply buy or sell a currency. You need another currency to trade with.

If you want to buy the USD, then you have to exchange it for another currency. In the EUR/USD example, if you want to buy dollars, then you are "selling the EUR" and therefore "buying dollars". It may seem complicated but let us explain more about how currency pairs are created.

When the currency pair is created, you decide which currency is the strongest. In the EUR/USD example the Euro was seen to be stronger than the Dollar and therefore goes first. If you trade this pair, then you are simultaneously buying or selling the base and therefore doing the opposite of the quoted currency. In this example, the base is the EUR, while the quote currency is the USD.

By trading currencies with each other, you are "trading" one currency for another. Traders can find value in many ways. You do not always have to trade the Euro against the Dollar. You can trade the Euro against the Yen or the Pound. This way you can take advantage of all the factors that make the currency markets move. In this example, if the EUR/USD is quoted at 1.5, this means that you need 1.5 dollars to buy 1 euro. The decision to buy and sell is based on the (first) basis of the currency pair. So, if you find the Euro rising, then you are buying this pair, you are buying the Euro at 1.5 and simultaneously selling the Dollar without this meaning that two transactions are taking place is only one involving two parties.

THE VALUE FOR A PIP - LEVERAGE

A pip is a unit that represents the smallest amount a currency pair can move in one direction or the other. In this example we use the EUR/USD at 1.1210

A \$100,000 position (often called 1 'lot') would be multiplied by 0.0001 = \$10 - a movement of one pip in the exchange rate will mean a loss or a profit of \$10, depending on whether it has gone long or short.

Note at this point that although the position is a \$100,000 position, you as the trader are not required to deposit that amount of money. In fact, due to the leverage effect, you will only be required to deposit a small part of this amount. How much would that be? Let us take a look at the table below.

Leverage is usually up to 100 times. The table shows the typical levels of leverage expressed as a ratio and as a percentage. If we take the example of the 100:1 leverage, this effectively means that for every 100 USD of position, we only deposit 1 USD. This is leverage power that be a buffer, but also as a sword is increasing its profits, but can also result in higher losses. This is exactly why there should be proper risk management.

LEVERAGE EXPRESSED IN PROPORTION	LEVERAGE EXPRESSED IN PERCENTAGE
400.1	0.25%
200.1	0.50%
100.1	1.00%
50.1	2.00%

When trading currencies, it is necessary to understand the trader's perception of value. This is where you have to balance the technical and fundamental aspects of trading. This is on average around 80/20% respectively. The combination of these two approaches will help you to get an advantage in this extremely competitive market.

Technical trading is based on charts. All candlestick charts, patterns, indicators, and oscillators that fall within the scope of technical trading.

Fundamental trading includes figures such as Gross Domestic Product (GDP), non-farm payroll or interest rate decisions. All of these will determine how people perceive the value of the dollar in the short, medium, and long term.

We will focus on the technical aspect of things, keeping in mind that self-fulfilling prophecy takes place when you operate on the technical side. Many people will recognize the same technical aspects and configurations, so the information provided becomes less relevant unless it is combined with other aspects of the market.

Technical trading is important when looking at the foreign exchange market, as it represents about 80% of transactions. All over the world, small traders, banks, and institutions are looking at the charts to make trading requests. You should have your own technical strategy when trading in the foreign exchange markets.



We have drawn here a certain movement of the Eur against the UD, where you can clearly see that it is a series of what we call Candles, indeed candles give us all the information we need, i.e. the rise, the fall, the opening and closing of that time frame. For now, we will focus on the fact that the EUR is above a considerable technical level and therefore seems able to reach a new maximum before reaching a new minimum.

Charts like this are the ones that traders draw and use every day. They are a way of providing a powerful message with a picture from the market and the product in question, providing various analysis tools.

Knowing the technical view of the "market" allows you to evaluate whether you are buying on "strength" or selling on "weakness".

As already mentioned, there is the other 20% that explains the movements of the market. And this is the fundamental aspect of trading, represented in any new news. Key data releases, spokespersons, or global events

US data will be a major influence on the dollar. Also, for most other markets. By understanding when this data is published through an economic calendar, you can trade with 20% potential change in this fundamental aspect. It is another way to structure your trading day, week or month so you know when key market movement data may affect the products you trade.

There are almost 200 currency pairs traded in the global markets. Not only the most popular, such as the EUR/USD or GBP/USD, but also the USD/JPY, AUD/CAD, EUR/CHF and the list goes on.

There are certain things to keep in mind when choosing your trading currency:

1. Darker currencies such as the GBP/NOK (British Pound versus the Norwegian Kroner) will incur higher margins and be more expensive to trade.
2. Large banks and institutions trade currencies in baskets. more than one pair at a time. Be aware of currency correlations and ratios. In summary, a correlation is a term used to denote or explain the relationship between one currency and another. In other words, what do we expect from one currency when another currency moves up or down? This is a particularly important notion to keep in mind.
3. The main news and data will generally affect the USD, GBP and EUR

so, as a beginner these pairs of coins are the best to get started.

In short:

The currency markets are the most liquid, with an estimated 4-5 trillion dollars traded each day.

For new traders this is a good place to start their trading activity, as they can easily get in and out of transactions. Also, with the amount of news from the US, from the possible recession to the higher interest rates, there are many things happening to keep the markets moving. Choosing risk based on the country's GDP in global comparison is a good start.

The ability to "hedge" and trade currencies with each other is also a perspective that many traders like. This way you can choose markets that are inversely correlated and trade two markets at once while making the most of your capital.

In short, hedging means protection and therefore traders tend to take opposite positions to protect themselves from sudden changes that will deteriorate their positions, bearing in mind that this could also mean giving up some of their originally projected gains.

In general, FX sounds complicated, but it is essentially about trading one country's outlook against another's.

WHAT IS OPERATIONAL RISK?

- Why you should control risk?
- What risk compensation indices are?
- It takes money to make money
- Short term risk vs. long term risk
- Why risk is important to you, not to the industry

Operating risk can simply be described as the amount of money you are willing to lose relative to what you are trying to gain from your operation. The market is not like fixed odd-numbered bets. If you had to bet something to win at a certain price, you would multiply the amount of your bet by the odds, or you would lose your bet. So $\text{USD}10$ on a 5/1 bet gives you $\text{USD}50$ back (plus your stake) and your risk is $\text{USD}10$.

However, when trading you can lose much more than your initial bet or investment. The amount of money you bet on the markets will change as the markets do. If you are on the right side of a play you win money, if you are on the wrong side of a play you can lose money. Risk, therefore, is the concept of managing this process.

We all know that it takes money to make money. The market is no exception. To put a trade on the market you have to cover your position, or what we call "margin". So, if you want to buy or sell 1 pound per point on the EUR/USD for example, depending on your broker, you may need 200 to 300 pounds in your account to do so.

You are not spending that 200 or 300 pounds, but you are using it to trade one pound in the market and to cover what "may" happen. This means that if you want to trade at $\text{£}10$ or $\text{£}50$ per point, the amount of money you have to keep in your account will have to increase accordingly.

The money you have in your account dictates the volume you can trade and also what you can risk losing in your failed trades. Remember that your risk must equal your potential profit. The greater the risk you take, the greater the return.

The amount of money you risk when trading should be less than the amount you have. There are rules and ways to manage risk, but only ultimately will you be able to decide how much money you invest in your trade. You can start trading with a few hundred dollars or you can put in a few hundred thousand dollars.

The amount of money you deposit will directly affect the amount of money you can earn, but also how much you can lose. Think of it this way. Why do so many new businesses fail? They run out of money. Why do many traders fail? For the same reasons. When you stop trading, that is when all risk management becomes a reality.

That is why you have to have a plan about what you're going to risk before you make a trade. There are no returns within the markets. Once you have bought or sold, the market will move whether you like it or not.

You can lose much more than you want in a short period of time if you are not prepared. Many traders get confused when they talk about investing or speculating. Speculation is more associated with the market. You are not looking to own anything, but to take advantage of price movements. This can happen with any kind of asset you can buy or sell. This is either short-term trading or speculation. You buy at point A and if that rises to point B, you will benefit from the price difference. A quick note to make sure we do not confuse trading with gambling.

Investing is more long term. If you are buying Apple stock as an investment, then you'll hold onto it for a significant amount of time. Months, years, maybe even decades. It is not as easy as it sounds, though, because you need these psychological characteristics to help you get through long periods of market decline and not be tempted to liquidate your positions.

Many traders, on the other hand, find that they do not like to trade as they do not like to see large fluctuations in their money. The shorter the time frame, the more movement you will see in your money. The longer the time frame, the smoother the fluctuations.

Trading risk is significantly different from investment risk and this should be made clear from the outset. When you are investing, then, you are considering a significant amount of time. You build a portfolio and balance the risk. This can mean having some cash, property, bonds, shares of different types of investments. The longer you have these investments, the more money you expect to make. In position will move more smoothly.

The risk that is managed is both in time and by the levels of diversification. By this we mean that you should not put all your eggs in one basket. This is not the case when speculating or trading.

Let us now look at the time factor. Time is a determining factor in defining when trading is your best friend and your worst enemy. The longer you keep trading, the more potential money you can make, but also the more risk you take. When trading, unlike investing, you can be in the markets for minutes, even seconds. The longer you are "exposed", the more you risk your capital.

There are four ways to manage risk due to the short time frame of operations:

- Using the right ratios
- Account %
- Applying stops
- Amount of available money.

Everyone has their merits and drawbacks. You should always decide which ones you will manage your risk with, when you are negotiating, before making a transaction.

That said, ratios are an easy way to manage both your risk and your expectations while trading. If you use the industry standard 2:1 trading ratio, you are trying to do twice as much as you are risking. Therefore, if you are trying to make 200 of a trade, then you will stop (you may decide to do so) when you are 100 usd out or negative. You can easily calculate your possible withdrawals and as long as you stick to a minimum 2:1 ratio, as long as you earn 50% of your trades over a period of time, the trade will still be profitable.

STOP ORDERS

Now is the time to take a closer look at how important our stops are and how we set them. Stop orders are those in which an order is placed at a fixed price in the market, so that the trading platform automatically takes you out at a certain price, and therefore, at a loss.

Stops are good for their ability to protect you from losing more when a situation gets out of control. If the market trades that price, you are automatically "stopped" out of that position by a loss. The main problem with stops is that you are at the mercy of market forces. Have you ever heard of a "pin bar" or a "stop

grabber", a "short squeeze"? All the parameters of market movements are designed to prevent traders from winning trades.

This is the balance of trading risk you must face on your own. If you set a money value stop, then you must have the discipline to stick to this amount. This is very difficult, as no one likes to push the button to take a loss.

From the stops, you have to physically exit the operation by pressing the button. This requires a lot of discipline. Many times, operators use this method, but they don't stick to it. Then they end up having a much higher loss than they initially intended. This is more for experienced operators. And even for them, this poses unnecessary risks.

STOP LOSS

A Stop Loss order is defined as the maximum loss the investor wishes to take on a market position. When the price reaches the level at which the stop loss is set, this order is closed with the losses we have chosen.

So now let's see how you should handle your stop loss... or how to live to trade another day. Often this is not a business where you buy cheap and sell expensive. It is about buying high and selling higher. Strength tends to produce more strength and weakness is followed by more weakness.

Stop Loss, in that sense, is classified as:

- Stop percentage
- Volatility stop (e.g. on the Bollinger Bands)
- Chart stop (in support or resistance)

Now let us say you have already defined your risk parameter. Once you have done that, we use the size of the position to calculate how far we will put the stop. Right?

We should always place stops in relation to the market or our system and not in relation to how much we can afford to lose. The market does not know how much we are betting and, to be fair, it doesn't care how much we are willing to lose. This is a quite common mistake among most traders, both novice and professional.

So why are volatility stops useful? In a 10k position on EUR/USD, for example, each pip is worth \$1 and 2% of your account in risk management is \$10 (from a 500 USD account). Therefore, the largest stop we can place is 10 pips. But looking at the EURUSD, the pair has most of the time a fluctuation of around 100 pips per day. Therefore, the 10 pip stop would seem to be too tight and we would be losing our position. We can instantly see that if we don't consider how volatility affects the average movement of each currency, it will result in a loss, even though in principle our strategy might have been correct.

A final note on stop loss: Let us take a look at the four tragic mistakes.

- The placement of the stops is too narrow. Traders do not consider the frequent oscillations, and therefore a tight stop results in an unnecessary loss.
- Defining the loss based on the size of our position. As said before, the market does not care how much money you can afford to lose.
- Placing stops too far or too wide. There must be a sensible placement of your stop given the past movements.

- Placing them exactly on the support/resistance lines, as many traders would think is obvious. But when something is obvious, it is obvious that it is wrong!

If your stop has been hit, the reason you had opened this exchange is no longer valid. No buts or butts. Do not adjust your stops to wider levels.

In short, losing trades are inevitable. It is simply part of the business. However, you can still lose trades and be profitable overall if you have an appropriate risk strategy. It should allow you to enter into operations with a degree of flexibility, but also protect your capital from significant reductions. It is advisable to combine ratios with stop loss orders and only in time will you know what best suits your risk appetite and trading style.

WHICH DRIVES THE FOREIGN EXCHANGE MARKETS

We will review:

- What are the foreign exchange markets, their structure, their size, their advantages?
- What is technical analysis, the essence of charts and what information they include?
- What is support and resistance, a key feature for novice traders?
- What are charts and the wealth of information they provide?
- What are indicators and oscillators, how can they help you achieve your goal?

With so many market participants involved in forex trading, we first need to look at what makes the forex market so interesting and attractive. With so much money, an estimated 4-5 trillion dollars traded each day in the forex markets, there are many ways for traders to make their buy and sell requests. With about 80% of all quote requests attributed to technical analysis, knowing your techniques is essential to gaining the advantage of trading in the foreign exchange market.

Keep in mind that currencies are traded in pairs, for example, USD/JPY or EUR/USD. When you buy a currency, you are simultaneously selling its pair, never just buying, or selling a single currency. However, you are executing a single trade, but the mechanics involve the simultaneous opposite position in the other currency. If, for example, you are buying the EUR/USD, it means you are buying the Euro AND selling the Dollar at the same time.

The demand for currency pairs is affecting many technical aspects of trading. Being a highly liquid market with the flexibility to trade 24 hours a day, but also the ease of going long or short and with the extensive use of leverage. All traders use charts and technical analysis. This is a must as you will find that many larger or smaller movements can be represented in a single piece of information such as the chart. The above does not explain 100% of your strategy but represents most of your trading decisions. The term that has been coined to denote that your decisions are made up of both technical and fundamental analysis is called, merger analysis.

There is a great deal of information about technical analysis. Technical analysis focuses on the data provided by the market. The market goes up, down, opens and closes. Once this information is recorded, it is set in stone, it is there for all to see. This means that everyone has access to the same information. However, the way we interpret this can be different. The important thing to remember with charts, support and resistance, trends and indicators is self-fulfilling prophecy. If most traders use them in the same way, then the markets are likely to respond.

All investment programs will give you access to the same operating tools. Type of charts (candlesticks, bars, points and figures), indicators, oscillators, as well as the tools to identify the main support and resistance lines or accumulation and distribution areas. You may already be familiar with the notions of head and shoulder formation, triple bottom, rising wedge, relative strength index, moving average, Bollinger Bands. These are some of the tools you can use or elaborate on to help you do your operations.

But not just you - everyone.

You will find that one of the main problems traders face with technical analysis is trying to reinvent it. They try to find combinations of technical analysis that other people may not have thought of. If you do this, then you will be the only one trading with this information and the powerful self-fulfilling prophecy of technical analysis will not be fulfilled.

With a vast selection of financial portals and specialized websites, we have instant access to both generic and more detailed information. For example, when you look at the charts on news channels, you usually see the line charts on Bloomberg terminals. These are excellent for illustrating price movement. A clear and simple chart that shows the direction of a product, i.e. an asset. However, they are not designed for the retail trader, like you, to use for technical analysis. There are a multitude of software programs that you can use to access information that you can use, and which are designed for retail traders. You may also find that most of the tools you need are included in the trading platform you are using.

CANDLES

For short-term and intraday traders, charts are an essential tool for data interpretation. The format in which they are viewed is also particularly important. The most accepted way to view technical data is by using candles. A way to visually represent all the necessary information on a single candle, as we will see below.

What are candles, then? Candles have existed since the 18th century. Steve Nison popularized the use of candlesticks in technical trading in his book "Japanese candlestick charting techniques". An essential manual for beginners. You might find that they come with funny names in an effort to describe a bullish or bearish situation (like Hanging Man, Abandoned Baby, Harami, Doji, etc.) but they are very useful.

His opinion was that people could use the Japanese candlestick methodology to interpret the data in a more understandable way and use individual candles and groups of candles for their own trading strategies.

The way a single candle displays all the vital information, with a different color to denote a negative candle (bearish - red) or a positive candle (bullish - green), has earned them their popularity.

Candles are considered the most reliable way to interpret technical data because each candle has five pieces of information. What is this?

- "The Rise", as shown in the example by the black line extended at the top.
- "The Down", as shown in the example by the black line extended at the bottom.
- "The Open", being the lowest point of the candle itself.
- "The Close", being the top point of the candle itself.
- Whether it is a buy or sell candle. A green candle will denote buying forces, while a red candle will denote selling forces.

The ease of this visual information makes each candle, by itself, very powerful in determining the direction of the market. Also, when candles are used in groups or formations, they again give more information about the potential direction of a market.

There could be a whole subject just about candles as there is a great deal of information and countless ways to interpret it. The basic principles are that individual candles can help determine certain short-term signals, such as the "hammer" that, at the bottom of a range, or a selling move could indicate that buyers will enter the market.

There are groups of candle formations, which are believed to be stronger signals as there are more candles to consider. Then there are groups of candle formations, which are believed to be stronger signals as there are more candles to be considered. This allows traders to spot key reversals or patterns of continuity in the current trend. These can be used for short, medium- or long-term trading ideas.

Candles are great for displaying information; however, they should be used with a combination of other indicators and oscillators. The key to trading technically is to have a balance of information. No one piece of information will give you everything you need to know to make sound trading decisions. You need a set of indicators, oscillators, as well as important factor, that of psychology, you must keep in mind that it is a vital part of our success since we are human beings after all and we are supposed to make rational decisions.

Understanding that the art of operating is to discover what is "obvious" to others is the self-fulfilling prophecy of technical analysis in action. If it seems that it should be a support, then it probably will be. Think of the levels of support and resistance as areas of "breakage" or "rebound". Or alternatively, do not categorize them as support or resistance but as points of interest. This way you can buy on the strength and sell on the weakness.

The art of being a good technical trader is not to marry an opinion. You should be happy to buy and sell. The long-term trend is for investors, not for traders. As intraday traders you only want to capitalize on the movement, not the overall direction.

TRENDS

Trend is your friend" is a popular term used in the market. This is true, but like everything else in trading, time is the key. When you trade truly short term, the overall trend is important, but you can make money by buying and selling around the trend.

Not all trends are perfect. You can have "false" outbreaks. Nothing in technical analysis is perfect. Imagine a breakout where the trend remained intact for a while, with prices falling. However, a point was reached where what acted as a resistance area has now broken and prices have begun to form higher levels with new candles outside the lines. This could be a temporary burst where prices return to that downward channel or it could be the beginning of a new trend, this time upward. This is how markets work.

Traders often think that they can only make money by buying strength or selling weakness. This is a good rule of thumb, but it is important to know, as with support and resistance, that markets are also broken.

THE TIME FRAME

"Time frame" in Forex trading refers to the unit of time on which the price chart you are looking is based. For example, in a Japanese candlestick weekly time frame chart, each candle represents one week of time. In a 5-minute Japanese candlestick chart, each candle represents 5 minutes of time. Shorter timeframes will show much more detail of price movement over time, but longer timeframes will present larger, longer-lasting pictures of price trends and ranges.

WHY YOU SHOULD USE THE WEEKLY TIME FRAME IN FOREX

An effective, profitable and powerful tool that you can use to trade Forex, is to pay attention to if there is a long term trend or range in any currency pair or cross, especially in the major pairs; and if so, where that trend is headed. Then make sure you trade in the same direction as that trend or reverse the support and resistance when there is no trend and the price is in range. Use a price chart with a higher time frame, such as the weekly time frame, to make such calls.

Although you can use a daily timeframe chart for the same purpose, you should use the weekly timeframe in Forex trading for this, as it is easier to judge very long-term price action immediately. It is also a good idea to break down and use at least one shorter time frame chart, such as the 4-hour or hourly time frames, to fine-tune your trade entries and exits to make them more accurate, which also translates into higher returns.

HOW TO MEASURE THE TREND WITH THE WEEKLY TIME FRAME

The reason why the weekly time frame is the best time frame for trading Forex, is because historical Forex data shows when the price is higher than several months ago, it is more likely to go up than down and vice versa, when the price is lower than several months ago. Therefore, if you pull out a weekly chart, an easy trick you can do to create the best trend indicator, is to count backwards 13 and 26 weeks from the current weekly candlestick. Is the price higher now than it being then? If so, you have a long-term upward trend. If it was lower in both, you have a long-term downward trend. If the results are mixed, you do not have a trend. Forget about all the fancy Forex indicators, this is a method that is quite simple and effective.

For example, the weekly chart of the EUR/USD currency pair below shows the current weekly candlestick on the far right, clearly below the opening candlestick prices of 13 and 26 weeks ago. Therefore, there is a clear downward trend, and this week traders can look for short trades in this currency pair.



Another example, the weekly timeframe chart for the GBP/USD currency pair below, shows the current weekly candlestick on the far right, closing above the opening price of the candlestick from 13 weeks ago and also below the opening price of the candlestick from 26 weeks ago. Therefore, there is no long-term trend, and next week traders who want to trade this currency pair, should look for reversals at the support and resistance levels.



INDICATORS AND OSCILLATORS

In technical analysis, the oscillator is the mathematical expression of the speed of the price movement over time. Depending on their shape, oscillators are advanced indicators. The basic concepts of the use of oscillators are overbought and oversold market conditions. The market is considered overbought when the price is near its upper limit and no further progress is likely. The oversold area is characterized by a low price, the further decline of which at the given time is unlikely. Although the analysis and use of oscillators is best represented during the stable state of the market, the complete change in trend can also be determined with the help of oscillators.

To identify the complete change in trend, it is necessary to understand the concepts of convergence and divergence of the given oscillator with the directions of the price movement.

Examples of Oscillators:

In the 1-hour USD/EUR chart below, we use the Parabolic SAR, as well as the RSI and Stochastic. As you have learned so far, when the stochastic and RSI start to leave the oversold region, it is a signal to buy. We found sell signals between 3:00am and 7am on 08/24/05. Each of these signals were given 1 or 2 hours apart from each other.



We also got sales signals from these three indicators between 2:00am and 5:00am on 08/25/05. As you can see, the Stochastic has been in the overbought region for quite some time, about 20 hours.

Usually when an oscillator is held at overbought or oversold levels for a long period of time, it means that there is a strong trend.

In this example, as the stochastic stayed in overbought, you can see that there was a strong upward trend.

Use three or four combinations of indicators and oscillators. Give it a try:

- Fibonacci
- RSI
- Bollinger Bands

Once you have studied and worked with most of these indicators and oscillators, you can discard what you consider to be noise for your own trading system and keep only what really helps you. In some cases, this might be just the price action. Or a simple indicator such as the moving average and perhaps two-time frames. It really depends on what style suits you. But the human tendency will be to overcomplicate. Do not waste your time finding the Holy Grail. Focus on simple strategies that will give you an advantage.

LESSON 2: FUNDAMENTAL TRADING – 80/20 RULE

FUNDAMENTAL TRADING

Let us now look at the fundamental aspect of foreign exchange. The fundamental data focuses on what is happening outside the charts. The common view is that 80% of the time the markets are trading technically, and 20% of the time the markets are trading for new information, so 20% is fundamental.

The fundamental side of the market is divided into three main categories:

1. Economic data
2. Key spokespersons/policy makers
3. Global events. These also fall within the systematic type of risk events, as markets would react strongly to them, being an event that nobody expects (terrorist attacks, natural disasters, etc.). Traders must be equipped with the necessary skills to diversify their risk among their positions and apply the so-called hedging strategies (i.e. protection)

Although the fundamental represents only 20% of the operation carried out, it can produce some of the largest movements and therefore possible profitable operations. All countries are responsible for publishing their own economic data. These data will come from government agencies. Non-agricultural payroll, for example, is published by the Bureau of Labor Statistics. This is to keep the figures independent and out of the private domain.

These figures are important in foreign exchange trading because they mean how well a country's economy is performing. A good US Gross Domestic Product (GDP) figure could mean that you would buy the USD over the EUR if the European Union data were not so favorable. If you multiply the number of data releases and the number of currency pairs you can trade, it soon becomes apparent that there are many ways to make money from the fundamental data.

CREATE A TRADING PLAN

We will now review:

- How to create an operational plan
- Key elements to remember
- Always plan before you decide to trade.

Some novice traders try to implement it by opting to trade on a trial account for a while. The demo account means that most of the time you are testing a software or markets in real time, with real prices, but with fake money. Traders put a plan in place and trade for a few weeks. Then they go to trade with a real account and discover that the reality is different. Why do you think that is? Because a trading plan without considering the real circumstances is not complete. Because their decisions will not be based on real psychological assumptions that they will face when trying to trade for real. A test account in all aspects is not one that replicates the true market environment. It just helps you get an idea of what you can expect out there. So please keep that in mind.

TRADING PLAN

A trading plan, then, not only prepares you for the actual transactions you will make, but also allows you to have a way of trading that you can repeat. This is the key to be a consistent and profitable trader. History tends to rhyme and so a more experienced trader will be able to identify similar patterns that resemble past actions, thus giving you an advantage

If you know the reasons why you won a business, you can repeat it. If you know the reasons you lost one, you can quit. It sounds simple but most merchants do not do this.

A plan helps you:

1. Enter the market. Where and under what circumstances do I open a position, whether long or short? What size position do I use?
2. Exit the market. More importantly, how do you exit a position? How much is enough?
3. Execute the changes. How do I manage my positions? Adjust them? Partial closure of winning trades?
4. Psychology. Getting used to taming your own behavioral traits, your eagerness to cut your profits and your habit of running your losses, for example. His tendency to trade what other people think is right at the time. Their eagerness to get confirmation from fellow professionals, whom they have no idea if they are good or trustworthy.
5. In case everything goes wrong. So basically, everything you need to become a successful trader.

TRADE PSYCHOLOGY

Now we turn to the psychology of trading, a major factor in our plan of operations. In a perfect world, you would take a trade based on the technical or fundamental aspects, assign the desired risk and that would be the hardest thing to do.

Unfortunately, there are other people in the markets. This creates fear, greed and irrationality. Furthermore, the market is only the sum of different opinions and prejudices - that of the market participants. And you have to trade not only against others, but also against yourself.

It is important to be aware that markets do not always move the way you want them to. It must be in your plan. What do you think and why? What does the market want you to think and why? They are rarely the same. Also, why do you lose even when your decision to trade was right? What do other people think about a change or a situation? Changing the behavior of the herd or choosing to be an opponent? These are just some of the questions this hot topic addresses. And most of the time, they are the most important ones.

So, as an operator, you are looking for value. You want to buy cheap and sell expensive, obviously. Or buy high and sell higher. If we all know this, then we must be mentally prepared to make it not as simple as that.

If everyone in the market has the same goal, to make money... do we really believe that the markets will act fairly and allow everyone to make the money they want? Of course, they do not. That is why markets tend to move in such a way that they put people in a position to get out of what would be winning trades, with a loss. It all comes back to fear and greed. But also, to the fact that most participants or those who want to be traders try to make the market pay for their needs and utility bills. A tragic mistake as you can imagine.

Have you ever thought what the markets want you to think? Have you ever heard the phrases?

- Stop grabber?
- Pin bar?
- Short squeeze?

These are all terms used in the markets to describe some of the short-term movements. If you are selling the markets and experiencing a "short term squeeze", what do you think is happening?

The market knows that traders (like you) are shorting or selling, so the market rises very aggressively and quickly, so traders liquidate their positions for a loss. The market then returns and does exactly what most other traders think it would. This short squeeze is how big traders, banks and institutions make MORE MONEY. They take your ideas and use them against you for their own benefit. Sound familiar? By being aware in your trading plan and that this happens, you can deal with this potential scenario.

You should always have a plan that allows you to get out before you do too much damage to your capital. So, this is also the role of your risk management and disciplinary actions. Your operating plan is just that. What you want to get out of operations. This can be as simple as a set of instructions or a set of handwritten steps. It can be a spreadsheet or a more sophisticated business plan approach.

At the end of the day it has to be something you refer to. You have to know why you took the trades you have, and also have some idea if you can repeat them. It is like planning anything else in life. Wouldn't you plan to buy a car? Or a house? Wouldn't you plan to make an investment as a business owner? I bet you would. Well, business is pretty much the same thing. After all, you are gambling your own money as in the previous situations. Why treat it differently?

It does not have to be fancy. It does not have to be the only way to trade. The most important part of a trading plan is that you acknowledge that you thought about what you were doing and, more importantly, why. This will only make you a better trader.