The FX Bootcamp Guide to Strategic and Tactical Forex Trading

WAYNE McDONELL

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Preface

> *"Planning is great matter to a general [forex trader]; it is the ground of death and of life; it is the way of survival and of destruction, and must be examined ... before doing battle, one calculates and will win, because many calculations were made."*
>
> *—A quote from The Art of War by Sun Tzu, a military general in ancient China. Scholars surmise that he lived around 600 B.C.*

PLAN YOUR TRADES AND TRADE YOUR PLANS

Why is trading forex similar to war? They are both a zero-sum game. In war, this means kill or b killed. In forex trading, this means that if you make a winning trade, someone else made a losing trac against you or vice versa.

Forex is pure. There is no central exchange in currency trading like there is for equities, such as tl New York Stock Exchange. It's simply bulls vs. bears. Hawks vs. doves. Those who think a currenc will gain value and those who think a currency will lose value.

Forex has no middlemen, few regulations, and is purely a global community of traders. No or controls the market.

For example, recently the central bank of New Zealand intervened to try to lower the value of tl country's currency. It worked for a few hours. Then traders pushed it back up. Traders control th market. No one else.

Why is this good?

Statistics have shown that most traders fail in forex. Some have reported less than a 10 perce success rate for new traders entering the market. However, this is great news for you:

- This means 10 percent of traders make *all* the money.
- Ninety percent of new traders fail because they do not acquire the skills, but more importantl they lack the patience and discipline to trade successfully.

FX Bootcamp's Guide to Strategic and Tactical Forex Trading will guide you on the path fro failure to success. However, the journey is yours to take. The question is do you have the guts to wor your butt off and get really good at trading forex?

Not clear enough? How about this?

I believe that 90 percent of amateur traders fail, not because they lack an understanding of tl market, but because they are not willing or able to do the work required to become an amazing trader

In forex trading, patience and discipline are just as important as technical and fundamental analysi

- Are you willing to give yourself enough time to learn how to trade?
- Are you willing to do the work?
- Will you do whatever it takes to succeed?

This book will help you develop positive trading habits and give you lifelong trading skills. It’s n a silly magic system of the moment.

This book will not do the work for you. But it will teach you how to stay out of a lot of bad trade and you will learn how to wait for the better trades. In fact, this book will to teach you how to thir for yourself and trade successfully on your own.

“... this book will to teach you how to think for yourself and trade successfully on your own.”

FX Bootcamp’s Guide to Strategic and Tactical Forex Trading will help you become a part of th top 10 percent that makes 100 percent of the money. (Blood, sweat, and tears not included.)

WHAT IS NOT IN THIS BOOK

Fluff! I assume that you know what a pip is and that forex volume is over $2,000,000,000,000 per da I'm not going to convince you to trade forex. You should be at or near that conclusion now all on you own.

This book *will* take care of the rest. It will teach you how the market works and how to trade it.

> NOTE
>
> For additional educational resources—including training videos, live webinars, chart examples, and more—please visit this book's free companion web site www.fxbootcamp.com/book.

Best regards,
Wayne McDonell
Chief Currency Coach
FX Bootcamp, LLC
www.fxbootcamp.com

Introduction

Sun Tzu teaches that there are four stages of planning for victory:

1. Gather intelligence.
2. Formulate strategy.
3. Execute plan.
4. Exit plan.

Creating a trade plan will:

- Help you control your emotions.
- Help you implement your analysis.

By reading the market first and then making logical entry and exit decisions based on yo thoughtful analysis *in advance*, you reduce the risk of making a poor trade. You simply set a trap fo price. If price falls into your trap, you trade your plan. If it does not, you set another trap and wait. other words, take the high ground and wait for your adversary to come to you. Do not fight on a lev playing field.

Your strategic planning will give you a tactical advantage and you are more likely to be victoriou You are not guaranteed success, but the odds are much more favorable and less risky. By creating plan in advance and waiting to execute it, you remove a lot of emotion from your trading. You are n longer reacting to the market, you are simply executing your plan. In fact, you will be spending mo time waiting for your trade setups than trading. Inevitably, this is less stressful.

Removing emotion will help you avoid stupid trades based on greed and fear. By relying on logic plans, your trading becomes repeatable. By trading when the market is behaving in predictable wa (this is what your plan really is—your prediction of future price action based on past results), you a removing stress.

Stress is a form of risk, and you need to manage it if you are going to succeed on a long-term basi Imagine trying to trade forex the next 30 years when every time you pull the trigger you start to swe bullets. Trading like this, you will eventually have an emotional breakdown. Reduce stress!

Planning your trades and trading your plans will reduce a lot of risk—and stress—in your tradi career. In addition, conservative, repeatable trade plans will also increase:

- Control
- Consistency
- Confidence

By virtue of the repeatability of your trade planning, you will control your emotions and bri consistency to your trading. Once you are able to trade profitably on a consistent basis, yo confidence will skyrocket.

In my experience working with forex traders from more than 50 countries around the globe, I kno that confident traders are much more likely to trade their plans.

When traders consistently plan their trades in advance and are confident enough to pull the trigg when they are supposed to, they have a sense of control. It may be an illusion, as the forex markets a chaotic, but think about it this way:

Who do you think the 10 percent of the traders making 100 percent of the money are?

a. The consistent and confident traders with a sense of control because they plan their trading advance.
b. The traders who pull the trigger based on gut feeling and who react to the market.

WHICH DO YOU DO?

Imagine you are at a cocktail party. People are floating around the room and mingling. We've all bee in situations like this.

The group next to you is talking about the latest reality TV show and you've never even heard of It sounds so incredibly stupid. What at bore!

I wonder what they would say if you jumped into the conversation with:

> "Speaking about being voted off the island, how about those FOMC meeting minutes releas this morning? Governor Pool voted to lower interest rates again! We should vote him off th island!"

It's likely that no one would have a clue about what you are talking about. Your life revolves arour acronyms such as CPI, PPI, NFP, PCE, GDP and such. They live lives of quiet desperation.

The next time someone approaches you and strikes up a conversation by asking, "So, what do yo do?" try using my favorite response.

"I buy and sell money."

Dumbfounded, the individual will respond with, "What?"

"I apply fractal geometry and chaos theory to profit from the global currency markets."

Now the person will be impressed. But don't say, "I'm a currency trader" as people equate this wi "gambler" and for the 90 percent of amateur traders who lose money, they'd be correct.

But not you; you are a professional profiteer. After reading this book, you will focus less on tradir and more on planning your trades in advance, as you are really seeking opportunities to profit, not trade.

If the odds are just 50/50, you'll pass as it will be too much of a gamble. You'll wait for a bette profit opportunity.

As Sun Tzu would recommend to a military general, I recommend to you, a currency trader:

Take the high ground and wait for your enemy to come to you. You are more likely to have a honorable victory. Even if you take the high ground and lose, because you gave yourself the best od of winning, you will be able to consider it an honorable defeat. However, if your adversary does n fall into your trap, you simply don't fight and live to fight another day.

In summary, strategic and tactical forex trading is not a system. It's a conservative and repeatab methodology.

Once you have learned, developed, and refined the trade planning skills outlined in this book, yo will certainly be on your way to being a part of the 10 percent who make 100 percent of the money. you are willing to work your butt off, it will just be a matter of time.

PART ONE

Basic Training

The goal for Part One is to develop a common language that you and I can use. The rest of the boo will discuss how the technical indicators highlighted in the first two chapters work together to tell story of what is happening in the foreign exchange (forex) market.

Currency charts use candles and technical indicators to communicate. It is important for you have a strong understanding of these building block indicators that form the foundation of the tradin methodologies discussed in this book.

To learn this language as you read this book, I highly recommend that you take the time to set u your charting package with these indicators and settings so you can practice the methodolog Members of FX Bootcamp have access to a template that makes this easy. Nonmembers will just hav to invest a little more time, but it will be worth the effort. Read the book, study the concepts, practic on your demo account, and develop long-term positive trading skills.

In Part One you will learn:

- The difference between a simple moving average (SMA) and an exponential moving averag (EMA).
- How to trade moving average crossovers.
- How to use the moving average convergence divergence (MACD) indicator.
- How to trade MACD divergence.
- How to use Bollinger Bands.
- How to trade volatility.
- How to spot a technical reversal.
- How to identify support and resistance (S&R).
- How to trade a break or bounce of S&R.
- How to trade S&R role reversals.
- How to use Fibonacci retracements.
- How to use Fibonacci extensions.
- How to use pivot points.

CHAPTER 1

Lagging Indicators

Most technical indicators are lagging, which means they are slow. They tell you what just happened after the fact. However, by combining historic price action with predictive price patterns, we'll hav enough evidence to form the basis of a trade plan.

In this chapter, you will learn how to use technical analysis to read your charts. It is critical important to learn these concepts well. They are key to understanding the market's behavior. Th technical indicators we'll discuss do not control the market, but they describe a story of how trade are trading it.

MOVING AVERAGES

A moving average (MA) is an average of a predetermined number of prices (such as closing pric calculated over a number of periods (such as 55 candles). The higher the number of candles in th average, the smoother the line is.

A moving average makes it easier to visualize price action without statistical noise. Instead o watching the up and down behavior of every candle, you are watching the relatively smooth movi average line. Moving averages are a common tool in technical analysis and they are used within a time frames: 1-minute, 5-minute, 15-minute, 30-minute, 60-minute, 120-minute, 240-minute, dail weekly and monthly candle charts, for example.

It is important to observe that a moving average is a lagging rather than a leading indicator. I signals occur *after* the new price movements, not before. Moving averages do not think ahead. The tell you what has happened, not what will happen. Nonetheless, moving averages have a critical role play in properly planning your trades in advance. The past does not always predict the future, but sure likes to repeat itself.

SMAs vs EMAs

There are two types of commonly used moving averages:

1. **SMA:** The simple moving average or arithmetic mean.

   This moving average is only an average. Add up all the candles that you'd like to measu and then divide by the number of candles you added together. For example, a 21 SMA calculated by adding the closing price of the last 21 candles and then dividing by 21. Simpl eh?

2. **EMA:** The exponential moving average.

   The exponentially smoothed moving average takes into account more than just the previo price information of the underlying currency. It places more weight on the most rece previous candles. This makes it more sensitive to the most recent price action. For example, 21 EMA places more weight on the last 5 candles than the first 5 candles.

The exponential moving average reacts to price changes more quickly than the simp moving average does because it pays more attention to newer candles.

I like moving averages a lot. You will see later in this book that at FX Bootcamp we use severa different moving averages at once, but they offer different pieces of the puzzle when planning o trades. When the market is steadily rolling along, moving averages keep us in our trades, but something changes, such as a moving average crossover, we'll likely get out or trade the ne direction.

Moving Average Crossovers

Moving averages are frequently used as price filters. To filter choppy price action into a more reliab indication for true price action, a short-term moving average has to cross a longer-term movin average.

The trade planning methodology we teach in the FX Bootcamp training sessions is to use sever moving averages on the chart simultaneously. The most obvious use for multiple moving averages to watch for crossovers to confirm new trends.

A crossover would consists of a short-term (21 candles) EMA that crosses a longer term EMA (5 candles). Short-term EMAs (fast) are more sensitive to price changes because they are measurin fewer candles. Conversely, longer term EMAs (slow) tend to be more flat and are less likely whipsaw up and down.

When moving averages do cross, you should take notice. If the fast EMA crosses below the slo EMA, it likely confirms new downward price action. If the fast EMA crosses above the slow EMA, likely confirms new upward price action. However, such crosses should not prompt you to place trade, as it often occurs too late and will put you in the market an unfavorable risk/reward ratio. Th crossover should have been part of the trade plan that you created in advance, as not every crossover the same. Moving average crossovers are great because they are easy to see and will attract trader but they simply do not replace the work of planning your trades.

A simple use of moving averages is using them to gauge the speed and direction of the trend. prices are held by the 21 EMA, the trend could be considered strong. If prices break the 21 EMA, yo should become more cautious. This could be the sign of a reversal or a consolidating market. Ne rules will apply. We'll discuss this in more detail later in the book, as it is a key concept to trad planning.

MOVING AVERAGE CONVERGENCE DIVERGENCE (MACD)

Moving average convergence divergence, generally known as MACD (pronounced "mack dee") is or of the most reliable and simple indicators in our toolbox. MACD is a trend-following momentu

indicator, or oscillator, which shows the relationship between two moving averages of recent price
An example is shown in Figure 1.1.

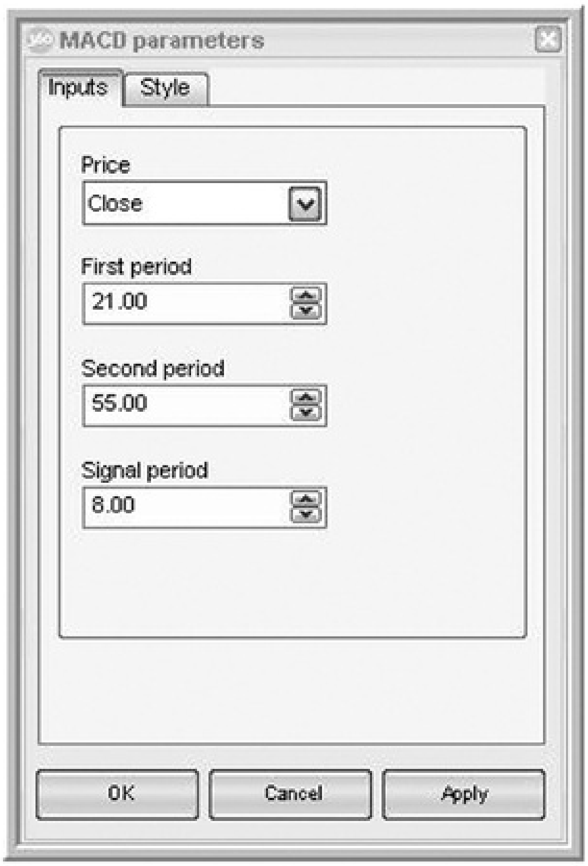
The MACD is often made up of three components:

1. **MACD Line:** The actual MACD line is calculated by subtracting a slow moving averag (EMA) from a fast EMA. In our example we use the 21 as the fast EMA and the 55 as the slo EMA.
2. **Signal Line:** The signal line represents an EMA, not of price, but of the MACD. In this ca we calculate the EMA of our MACD for the last eight bars.
3. **Histogram:** The MACD histogram is the difference between the MACD and its signal line.

MACD just might be the most popular indicator used by forex traders. That is why we recommen that you use it. However, be aware that MACD is often misused. Like any other technical indicato you cannot rely on it for trades. It should be part of your entire trading planning process.

FIGURE 1.1 Moving Average Convergence Divergence (MACD)

Source: DealBook® 360 screen capture printed by permission. c 2008 by Global Forex Trading, Ad MI USA



How to Use MACD

There are three common scenarios to watch for:

1. **Crossovers:** When the MACD falls below the signal line it is a bearish signal, and indicat that it may be time to sell. Conversely, when the MACD rises above the signal line, th indicator gives a bullish signal, and suggests that it may be time to buy.

2. **Divergence:** When the price diverges from the MACD, it signals the end of the current tren
When the price is rising and MACD is falling (negative divergence), or vice versa, it can b
considered an indication of something going on and can be used to predict changes in a tren
That's right, the lagging indicator that is supposed to follow the price is predicting futu
behavior.
3. **Dramatic Expansion:** When the MACD expands dramatically—that is, the shorter movi
average pulls away from the longer term moving average—it is a signal that the currency
overbought/oversold and may soon return to normal levels.

Once again, let me be perfectly clear. All three of these scenarios are important and should not b overlooked. However, none of them are signals to trade. They are opportunities to form trade plan based on likely outcomes commonly generated by such situations.

For example, MACD divergence is tradable only when confirmed by other indicators. It does n always yield profitable trade opportunities. Therefore, if you traded every MACD divergence, just lil if you traded every moving average crossover, you would certainly lose money.

However, when planned in advance and confirmed with other technical indicators, success is muc more likely. This is because several things are happening at once and each is attracting the same bul or bears into the trade you are planning.

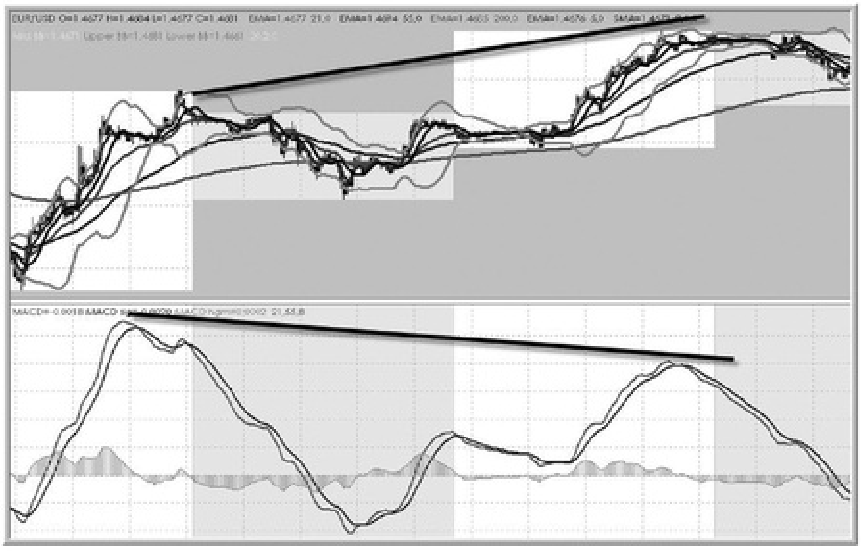
MACD Divergence

MACD crossovers and dramatic rises are easy to spot. However, spotting MACD divergence takes little practice. Figure 1.2 shows some examples of charts that display MACD divergence signals.

What does this divergence mean? Just that the current price trend is running out of steam. In th case, you'd create trade plans based on reversal patterns, moving average crossovers, or oth indications to consider a trade in the opposite direction. It may not happen right away, but MAC divergence can be a powerful hint that the market is changing.

FIGURE 1.2 Examles of MACD Divergence

Source: DealBook® 360 screen capture printed by permission. c 2008 by Global Forex Trading, Ac MI USA



What you are looking for is when price action and MACD do not agree. For example, if price making a series of higher highs and MACD is making a series of lower highs, something between t two is out of sync.

I see MACD divergence as a sign that fewer and fewer traders are in the trend. No one is tradi against the trend—yet, but fewer and fewer traders are in the trend. I'd guess that traders are gettir nervous and slowly fading out of their trades.

When the only traders in a trade are nervous, they are likely to exit their trade at the first sign trouble. So if MACD is diverging from a bullish trend, as soon as the bears muster up enough guts short, the bulls will exit and the bears will take control. This is exactly why MACD divergence can l so powerful. When it works, it often works well, but it takes time to set up.

There are two powerful keys in locating possible times where divergence is likely to represent reversal in price.

1. **Support and Resistance:** MACD divergence can be powerful when price is at double tops double bottoms. Just as you are creating a trade plan based on a bounce or break of S&R, yo spot MACD divergence, which is a sign that current price action is running out of steam. Th would indicate that there are not enough committed traders to break S&R, so perhaps yo should focus your trade plan on a rejection reversal. See Figure 1.3.
2. **Exhaustion Pullback:** The second is when an oscillator, an overbought /oversold indicato has reached its overbought/oversold range and is turning back down to normal. You may ofte see the MACD lines extremely overbought or oversold. This is *not* a reason to trade. In fact, indicates signs of strength.

Remember this: "Of course it's overbought; everyone is buying!" Don't confuse the overbought oversold MACD zones as trade opportunities. However, when *price* reaches its extreme, where it gone too far too fast, you will see price exhaust and the MACD lines drop back into the normal zon This is often a better signal. See Figure 1.4.

Combining an exhaustion MACD pullback with MACD divergence at a double top, you would hav a second cross of the MACD and an opportunity to trade.

FIGURE 1.3 MACD Divergence Trending Up