
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 be killed. In forex trading, this means that if you make a winning trade, someone else made a losing trade against you or vice versa.

Forex is pure. There is no central exchange in currency trading like there is for equities, such as the New York Stock Exchange. It's simply bulls vs. bears. Hawks vs. doves. Those who think a currency 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 one controls the market.

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

Why is this good?

Statistics have shown that most traders fail in forex. Some have reported less than a 10 percent 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 importantly 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 from failure to success. However, the journey is yours to take. The question is do you have the guts to work 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 the 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 analysis.

- 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 not 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 trades and you will learn how to wait for the better trades. In fact, this book will to teach you how to think 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 the 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 day. I'm not going to convince you to trade forex. You should be at or near that conclusion now all on your 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 your thoughtful analysis *in advance*, you reduce the risk of making a poor trade. You simply set a trap for price. If price falls into your trap, you trade your plan. If it does not, you set another trap and wait. In other words, take the high ground and wait for your adversary to come to you. Do not fight on a level playing field.

Your strategic planning will give you a tactical advantage and you are more likely to be victorious. You are not guaranteed success, but the odds are much more favorable and less risky. By creating a plan in advance and waiting to execute it, you remove a lot of emotion from your trading. You are no longer reacting to the market, you are simply executing your plan. In fact, you will be spending more 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 logical plans, your trading becomes repeatable. By trading when the market is behaving in predictable ways (this is what your plan really is—your prediction of future price action based on past results), you are removing stress.

Stress is a form of risk, and you need to manage it if you are going to succeed on a long-term basis. Imagine trying to trade forex the next 30 years when every time you pull the trigger you start to sweat 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 trading 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 bring consistency to your trading. Once you are able to trade profitably on a consistent basis, your confidence will skyrocket.

In my experience working with forex traders from more than 50 countries around the globe, I know 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 trigger when they are supposed to, they have a sense of control. It may be an illusion, as the forex markets are 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 in 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 been 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. It sounds so incredibly stupid. What a 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 released this morning? Governor Pool voted to lower interest rates again! We should vote him off the island!”

It's likely that no one would have a clue about what you are talking about. Your life revolves around 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 you 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 with “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 trading and more on planning your trades in advance, as you are really seeking opportunities to profit, not to 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 better 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 an honorable victory. Even if you take the high ground and lose, because you gave yourself the best odds of winning, you will be able to consider it an honorable defeat. However, if your adversary does not 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 repeatable

methodology.

Once you have learned, developed, and refined the trade planning skills outlined in this book, you will certainly be on your way to being a part of the 10 percent who make 100 percent of the money. If 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 book will discuss how the technical indicators highlighted in the first two chapters work together to tell the 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 to have a strong understanding of these building block indicators that form the foundation of the trading methodologies discussed in this book.

To learn this language as you read this book, I highly recommend that you take the time to set up your charting package with these indicators and settings so you can practice the methodology. Members of FX Bootcamp have access to a template that makes this easy. Nonmembers will just have to invest a little more time, but it will be worth the effort. Read the book, study the concepts, practice 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 average (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 have 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 critically important to learn these concepts well. They are key to understanding the market's behavior. The technical indicators we'll discuss do not control the market, but they describe a story of how traders are trading it.

MOVING AVERAGES

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

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

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

SMA 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 measure and then divide by the number of candles you added together. For example, a 21 SMA is calculated by adding the closing price of the last 21 candles and then dividing by 21. Simple, eh?

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

The exponentially smoothed moving average takes into account more than just the previous price information of the underlying currency. It places more weight on the most recent 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 simple 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 several different moving averages at once, but they offer different pieces of the puzzle when planning our trades. When the market is steadily rolling along, moving averages keep us in our trades, but when something changes, such as a moving average crossover, we'll likely get out or trade the new direction.

Moving Average Crossovers

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

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

A crossover would consist of a short-term (21 candles) EMA that crosses a longer term EMA (50 candles). Short-term EMAs (fast) are more sensitive to price changes because they are measuring fewer candles. Conversely, longer term EMAs (slow) tend to be more flat and are less likely to whip saw up and down.

When moving averages do cross, you should take notice. If the fast EMA crosses below the slow EMA, it likely confirms new downward price action. If the fast EMA crosses above the slow EMA, it likely confirms new upward price action. However, such crosses should not prompt you to place a trade, as it often occurs too late and will put you in the market at an unfavorable risk/reward ratio. The crossover should have been part of the trade plan that you created in advance, as not every crossover is the same. Moving average crossovers are great because they are easy to see and will attract traders, 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. If prices are held by the 21 EMA, the trend could be considered strong. If prices break the 21 EMA, you should become more cautious. This could be the sign of a reversal or a consolidating market. New rules will apply. We'll discuss this in more detail later in the book, as it is a key concept to trade planning.

MOVING AVERAGE CONVERGENCE DIVERGENCE (MACD)

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

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

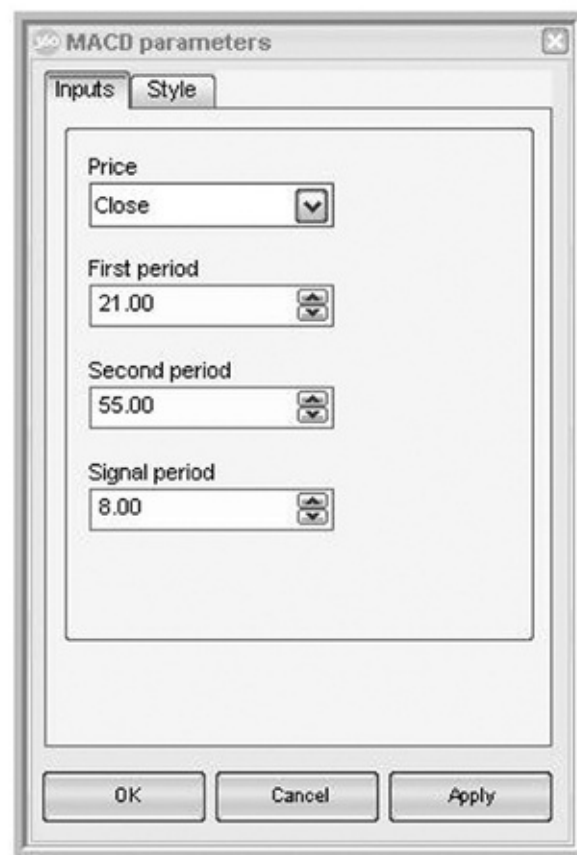
The MACD is often made up of three components:

1. **MACD Line:** The actual MACD line is calculated by subtracting a slow moving average (EMA) from a fast EMA. In our example we use the 21 as the fast EMA and the 55 as the slow EMA.
2. **Signal Line:** The signal line represents an EMA, not of price, but of the MACD. In this case 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 recommend that you use it. However, be aware that MACD is often misused. Like any other technical indicator 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, Ac 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 indicates that it may be time to sell. Conversely, when the MACD rises above the signal line, the 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 trend. ~~When the price is rising and MACD is falling (negative divergence), or vice versa, it can be~~ considered an indication of something going on and can be used to predict changes in a trend. That's right, the lagging indicator that is supposed to follow the price is predicting future behavior.
3. **Dramatic Expansion:** When the MACD expands dramatically—that is, the shorter moving average pulls away from the longer term moving average—it is a signal that the currency is 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 be overlooked. However, none of them are signals to trade. They are opportunities to form trade plans based on likely outcomes commonly generated by such situations.

For example, MACD divergence is tradable only when confirmed by other indicators. It does not always yield profitable trade opportunities. Therefore, if you traded every MACD divergence, just like 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 much more likely. This is because several things are happening at once and each is attracting the same bulls or bears into the trade you are planning.

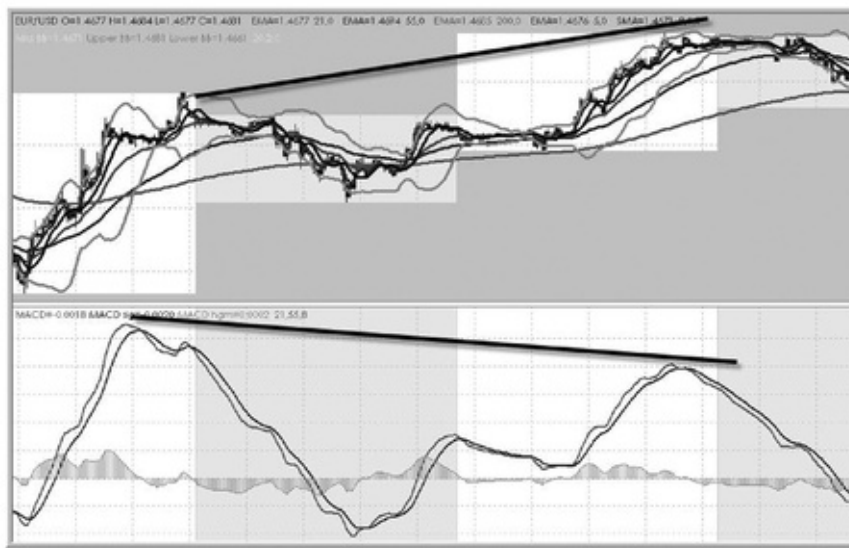
MACD Divergence

MACD crossovers and dramatic rises are easy to spot. However, spotting MACD divergence takes a 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 this case, you'd create trade plans based on reversal patterns, moving average crossovers, or other indications to consider a trade in the opposite direction. It may not happen right away, but MACD divergence can be a powerful hint that the market is changing.

FIGURE 1.2 Examples of MACD Divergence

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

I see MACD divergence as a sign that fewer and fewer traders are in the trend. No one is trading against the trend—yet, but fewer and fewer traders are in the trend. I’d guess that traders are getting 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 of trouble. So if MACD is diverging from a bullish trend, as soon as the bears muster up enough guts to go short, the bulls will exit and the bears will take control. This is exactly why MACD divergence can be 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 a reversal in price.

1. **Support and Resistance:** MACD divergence can be powerful when price is at double tops or double bottoms. Just as you are creating a trade plan based on a bounce or break of S&R, you spot MACD divergence, which is a sign that current price action is running out of steam. This would indicate that there are not enough committed traders to break S&R, so perhaps you 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 indicator has reached its overbought/oversold range and is turning back down to normal. You may often see the MACD lines extremely overbought or oversold. This is *not* a reason to trade. In fact, it indicates signs of strength.

Remember this: “Of course it’s overbought; everyone is buying!” Don’t confuse the overbought or oversold MACD zones as trade opportunities. However, when *price* reaches its extreme, where it has gone too far too fast, you will see price exhaust and the MACD lines drop back into the normal zone. This is often a better signal. See [Figure 1.4](#).

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

FIGURE 1.3 MACD Divergence Trending Up

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