FOREX TRADING:

HAT TRICK! 3 EASY ENTRY AND EXIT STRATEGIES

AXITRADER

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Foreword

Trading is an incredibly hard past time, but it doesn't have to be. Education is key to your development but with so many websites, videos, and general material it's hard to know what will help, and what will lead to information overload. In my experience it's always best to stick to the basics, I've seen so many examples in my career of traders who have jam packed charts with indicators, or learnt the ins and outs of various complicated trading strategies without understanding the basics of risk management, stops and limits, even in some cases how to actually place a trade.

The eBooks on offer here give you that information, they give you the basics and then look to build on that base knowledge to leave you in the best position to continue, or begin your trading journey. The information provided is not just for the novice either, the eBooks go a long way to cater for traders with different skill sets. I myself am a qualified technical trader, the information provided in this series is not just your bog standard technical analysis it's in depth enough to give the experienced trader useful tips, but digestible enough to be the perfect help for the beginner.

James Hughes

Chief Market Analyst

AxiTrader

The secrets to success are not really secrets at all!

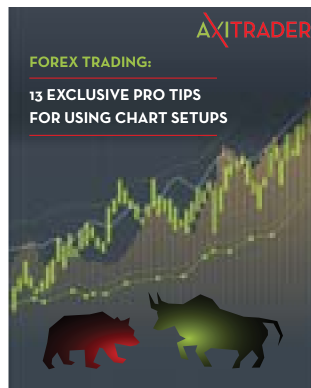
Traders who succeed in the forex market are those who have developed a successful strategy. And such strategies can be replicated and taught.

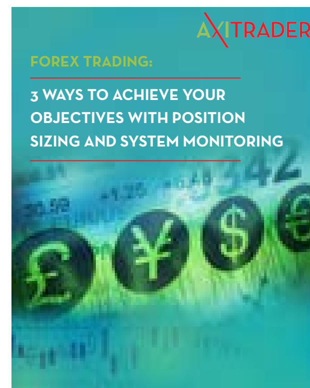
This ebook is the third in a series of five that focus on Building a Successful Forex Trading System. In this series of ebooks, you'll find information that's based on several years of studying top traders and the application of their principles.

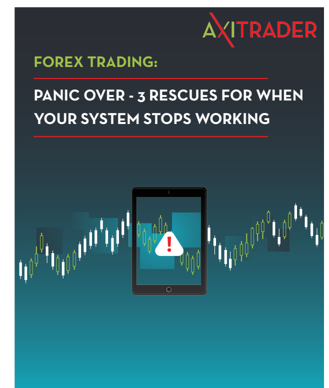
These learnings have been shared with a single objective – To empower you with the knowledge that can make the difference between success and failure in forex trading.

In this ebook, you'll learn about entry and exit strategies. You will get to know how to identify when to enter a trade, where to place your stop and when to exit as well as about tight markets and difficult-to-hit stop-losse

Others in the Series to Help You Build a Successful Forex Trading System



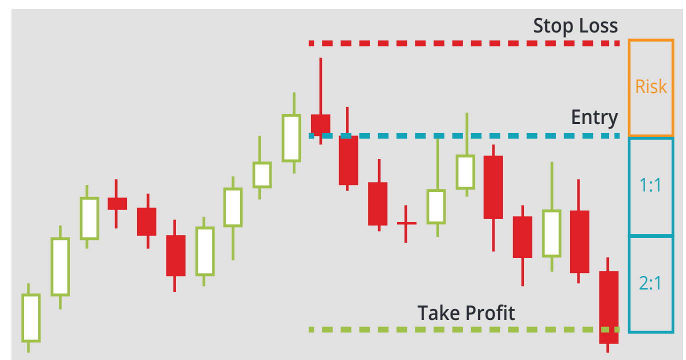




Introduction

The questions most frequently asked about forex trading are:

1. When to enter
2. Where to place your stop
3. When to exit.



These are, of course, some of the most important questions you need to answer in your forex trading plan. Together they form the decision-making engine of your Forex trading system.

Over the next three chapters we will cover each of these questions. But, before we get started, the first step is to understand how they fit into your trading plan. While entries and, particularly, exits are critical to your system's performance, we have not yet touched on your trading psychology, your position-sizing model, how to trade mistake-free, or the power of objectives.

You can have the best entries and exits in the world and still lose if you don't integrate all these factors into a cohesive plan. My belief is that around 15% of your energy should be spent on this area, with the majority of that time on the exit part of the equation.

You've spotted it, right?

This chapter started by talking about the importance of entries and exits however, they are not to be treated with such reverence.

The reason this is important is that if you are too focused on searching for the Holy Grail entry, you will experience a major time-suck... or worse, end up with a half-baked system that costs you not just time but also money.

1

SIMPLE ENTRIES AND RE-ENTRIES

The true role of entries and exits

Each trade is like a calculated draw from what would otherwise be a lucky dip.

The more accurate you can make your entry and exit points, the more winners you're likely draw and the more effective your forex trading system will be in meeting your objectives. Your goal for entries and exits is to add as many winning tickets into the draw as possible – or to add in tickets that, when you do pull them, give you a better chance of hitting the jackpot.

When you internalise this concept, you can start to see how entries and exits fit into the bigger picture of your forex trading system. They lose their mystical appeal. You don't need to have a system that is perfect, just one that produces success over time and builds a foundation aimed to ensuring you:

1. Do not experience a drawdown over 25% (it's hard to recover from a drawdown this large without being extra risky – see the table);

2. Achieve your objectives over time.

Recovering From a Drawdown	
Trading account loss %	Gain required to recover %
5	5.3
10	11.1
15	17.6
20	25.0
25	33.3
30	42.9
35	53.8
40	66.7
45	81.8
50	100.0
55	122.0
60	150.0

Are high probability entries better?

Building a trading system is a little like building a house.

When you construct a house, you decide how many rooms it will have, the layout, how many floors and so on. These decisions are based on your needs (objectives), budget (trading capital) and what suits your personality (psychology).

Similarly, when you develop entry and exit rules for a forex trading system, you choose things like risk/reward ratio, win rate and the number of trades over

a time period (i.e., five trades a week). Your choices here will be a reflection of your needs, budget and goals

Take a look at these three basic examples of Forex trading systems.

SYSTEM 1	System 1 generates 10 trades a month with a 90% win rate. Winning trades make $100 and losing trades lose $1,000.
SYSTEM 2	System 2 generates 80 trades a month with a 60% win rate. Winning trades make $60 and losing trades lose $50.
SYSTEM 3	System 3 generates 10 trades a month with a 15% win rate. Winning trades make $1,800 and losing trades lose $150.

Before you read on, which system would you prefer? Note it down along with the reasons why it is your system of choice.

Here are the results for a month's trading for each system in dollars:

- System 1 with a 90% win rate had a $100 loss
- System 2 with a 60% win rate had a $1,280 profit
- System 3 with a 15% win rate had a $1,425 profit.

What do you notice here?

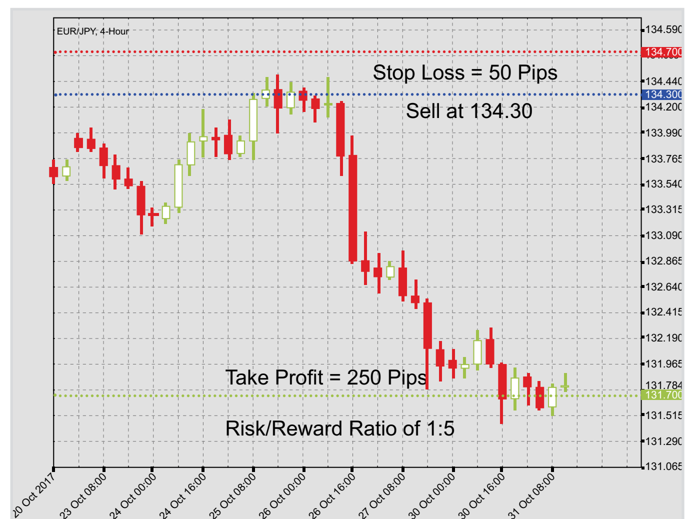
The system that made the most profit had the lowest success rate – and the system that lost money had the greatest success rate.

Now, would you still choose the same trading system you chose above?

When you are developing your entry and exit, the one with the most wins isn't always the best. Be careful not to fall into this trap.

(As a side note, it is possible to have a system that has a high win ratio and larger losses than profits. It's just tough if you experience four or five losses in a row, so make sure you position size accordingly.

A risk/reward ratio filter for your trades



Entries and exits should never exist independent of each other. Their relationship can be expressed though the risk/reward ratio. Your risk/reward ratio is how much you can potentially profit on the trade, compared to your initial risk.

You determine this by working out your initial stop and profit objective. For example, if you are risking $1 to make $3, you would have a risk/reward of 3:1.

It can be beneficial to have a rule in your trading plan that you only place trades that have a certain risk/reward ratio.

You may only take trades that have a risk/reward ratio of 3:1 on longer term positions, or of 2:1 on shorter term positions.

Entries vs. re-entries

For the sake of system development, we define some types of entries as re-entries. Re-entries occur in two circumstances:

1. The initial entry is stopped out, but the set-up conditions still exist, i.e., a breakout fails and then goes back within the range before attempting to breakout again.

2. The initial entry is successful, and you get a new set-up that you want to take, i.e., you enter on a breakout and the market starts to trend. You then get the chance to add an additional position based on a pullback in the trend.

The trick to using re-entries is in the planning. If you have just had a losing trade, or are already in a profitable position, it can change your psychology and cause you to make mistakes.

Note down in your trading plan exactly what you will do in a re-entry scenario.

Reversals

Occasionally you will be in a trade and get a set-up for a trade in the opposite direction. Like reentries, these can be a little difficult psychologically, as you could be influenced by your current positi

What to do?

As above, it is all in the planning.

Note in your trading plan:

- What constitutes a reversal?
- Under what circumstances will you take a reversal?
- What if you get another reversal after you have already taken a reversal? Do you reverse again?

Simple entry techniques work

Simple entry techniques allow you to focus on managing your trade, once you enter, rather than on interpreting a jumble of indicators to work out the best time to buy. A good entry has two main criteria:

1. **The set-up:** A set-up is a condition you watch for prior to entering your position. Once your set-up occurs, you then move into stalking mode for a high-quality entry.
2. **The entry:** Now, you become the hunter, spear in hand, pursuing a high-quality entry with dogged determination. You are face-to-face with the markets, unwavering while you wait for the perfect moment to strike.

When the time comes, you execute with aplomb, your supreme skill ensuring you net your target with ease...

Typically, you will look to drop to a lower timeframe from your setup to improve the risk/reward ratio. You could then employ technical analysis, such as candlestick analysis, for the actual entry. For example, on a USD/CAD trade, if you go to a lower timeframe, you would see a strong reversal pattern (a spinning top followed by the bullish engulfing candle) that will allow you to get in earlier and improve the risk/reward ratio.

Entry methods that work

Almost all entry methods work, but they work differently depending on your set-up, psychology, objectives and the market type.

CANDLESTICK PATTERNS

Price action candlestick patterns can be excellent entries as these give an indication of the buying and selling pressure between market participants.

Indicator cross-over

Indicator cross-overs are popular for their simplicity. They tend to work better in trending markets.

Some indicators that can be used for this approach include:

- Moving averages
- MACD
- Stochastics

PRICE CROSSES MOVING AVERAGE

As a variation of the moving average cross-over approach, simply place your trade when the price either touches or closes over the moving average. You will find that you get into your trade earlier, but that you suffer more whipsaws.

The chart has been enlarged so you can see the difference

BREAKOUT

There are 2 main ways you can use to trade a breakout:

1. Use a limit or stop order that enters automatically once the price moves outside the range. This will ensure you get in even if the breakout bar is strong.

2. Wait for the price to close outside of the breakout range. You may avoid some whipsaws with this method, although at the cost of either missing the breakout or entering later with an inferior risk/reward.

SUPPORT AND RESISTANCE LEVELS

Gutsy traders can enter on support and resistance, trusting in the level to hold. This entry can improve the risk/reward on the trade but can decrease your percentage of wins.

In summary, here's a look at the entry process in its entirety:

1. Wait for your set-up conditions
2. Drop to a lower timeframe
3. Apply your chosen entry technique
4. Check whether the risk/reward is acceptable

Once you have entered, the real trading begins. You need to manage your trade to capitalise on how the market moves. You do this using complex exits.

2

COMPLEX EXITS

Complex exits are essential to building a successful Forex trading system that works for you. The term "complex exits" is somewhat misleading.

Each exit is quite simple on its own. The complexity comes with the variety of exits that are required so that you can:

1. Trade what is in front of you
2. Achieve your objectives.

It is how you react to what happens after you enter the trade that matters. Here is a list of some exits to consider for your trading system.

Profit target

A profit target is an order you place to close your position, once it hits a certain price. These are useful in sideways markets, but some experts believe they work well in trends too.

Profit objective

Profit objective is the goal for your trade. When you understand your system, you will know how much profit trade is capable of making.

You can then manage the trade in a way that seeks to maximise profits

Does it sound a bit mystical?

In essence, it is about letting profits run or altering profit targets, based on what the current market condition and what your analysis suggests is likely in the near future. However, make sure to identify your objectives before placing an order.

Trailing stop (price or indicator)

A trailing stop (surprise, surprise) trails the current market price. An entire book could be written on trailing stops, given how many there are. Suffice it to say, they can be based on a set price (say, 50 pips) behind th market or they can be based on an indicator, such as a moving average.

If you like moving averages, try displaced moving averages. There is something to them, but it's best not to use them these days, as it's better/good practice/recommended to look at price action for exits. However, they are very good for certain trading styles.

Here's a look at two especially important types of trailing stops.

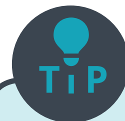
1. RAPID MARKET TRAILING STOP

Sometimes the market defies gravity and launches into a rapid move, only to come crashing back down.

If you are in a trade that takes off like this, then you can adjust your trailing stop to avoid giving back your gains. Perhaps you go to a lower timeframe or are prepared to only give back one or two times your risk. You can see on this one-hour chart on the USD/JPY how speedy moves can quickly reverse.

2. SUPPORT AND RESISTANCE TRAILING STOP

Support and resistance are difficult prices for th market to move through. They also form a platform for a further extension of the price. With a support and resistance trailing stop, you logically trail your stop behind the market in order to protect profits



Be wary of short, sharp penetrations of resistance levels, and be ready to get back in using a re-entry

Price action

You can exit based on price action. For example, you might see a candlestick reversal pattern that indicates the trend is coming to an end.

Large daily move

Depending on your trading timeframe, if there is a large daily move of, say, 300 pips, you could look to sell as the market has most likely overshot.

Fundamental exit

You can exit a position, based on market fundamentals and news. For example, you might close out of your short-term positions prior to a major news announcement or exit a position following negative news.

Time stop

You may exit after a specific period of time in a trade or on Friday, before the market closes for the weekend. Cross rates-savvy traders often monitor cross rates to get an indication of the direction of the currency pairs they are trading. If the price action on the cross rates is signalling weakness, then it might be time to exit your trade.

Expert exit

If you follow a particular expert, you may choose to close your position if they suggest the market is about to turn.

Risk/reward stop

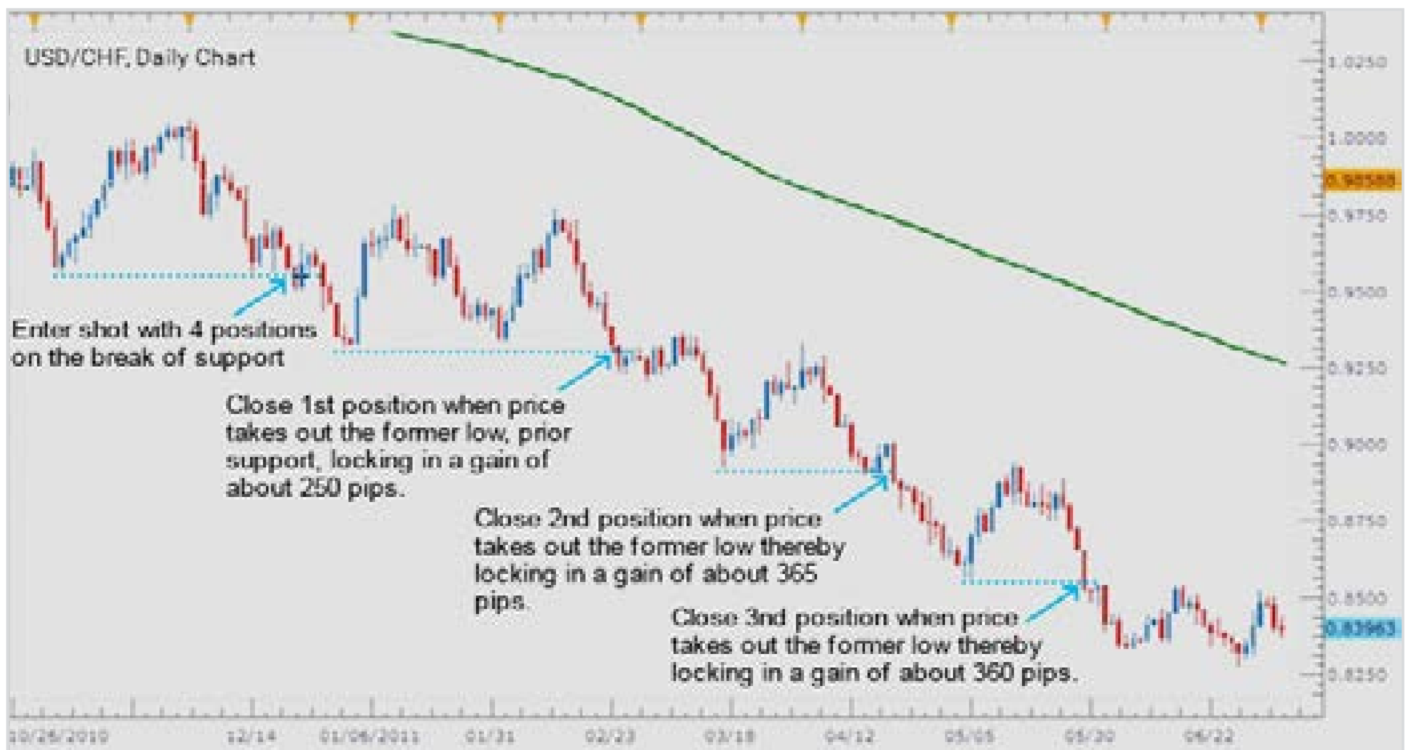
With a risk/reward stop, you adjust your stop loss to maintain a minimum risk/reward of 1:1 at all times. This powerful approach helps you to maintain your profits if your trade gets close to your profit target, does no touch it, and reverses.

Account target

If you have a specific account-based goal, such as 25% for the month, then you may close all positions in your account once this target is achieved.

Scale out

By scaling out, you exit portions of your position, based on different criteria. For example, you might take a small amount off when the market first makes some available, some more at a pre-planned target, and finally lea some on a trailing stop to capture the big wins.



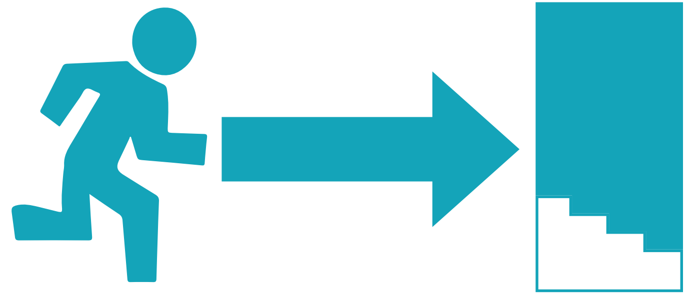
Complex exits enable you to trade the market in front of you.

By having a variety of exit systems in your toolbox, you can effectively manage your position based on what happens in the market after you enter.

You can *intently* watch the market and adapt to its movements in order to generate the best possible result for your trade.

Be in the moment with it.

As a trader you can only plan and then be present. Once you execute the trade you are simply experiencing, not creating. Your exit decision should be based on what the market is doing right now, rather than on a perfect recreation of a historical pattern that conforms to your back-tested indicators.



It's not difficult, especially if you enter simply and apply the right exit to the right scenario

As always, it's encouraged to get out your trading plan or trading journal and integrate this lesson into your forex trading system for maximum effect. Pick one or two exits from the list you'd like to add today. Over time you can come back for more.

3

DIFFICULT-TO-HIT STOP-LOSSES

Do you sometimes feel like the market is out to get you?

Have you ever had your stop hit at what turned out to be the low? Was it just bad luck? Or is there something more at play?

The chances are there actually is!

Forex trading is a zero-sum game and you can bet that the strong players (the bank dealers), with more information, more money and the ability to move the market, are out to get as much easy profit as they can. This means that retail players (you and me) are left holding the weak hand. So, they better watch out.

But the dealers can be beaten.

Having the advantages, dealers do breed complacency. Most of them are not actually very good traders, once you take them away from their screens and their order flow information. They also are not good at risk management, when they don't have corporate orders to backstop their poor trades.

[Corporates are the real losers in the forex market. Retail traders (and other not-so-savvy bank traders) do provide a constant source of profit for bank dealers, but we are still small fry compared to the seven trillion dollars of foreign currency that are traded each day.]

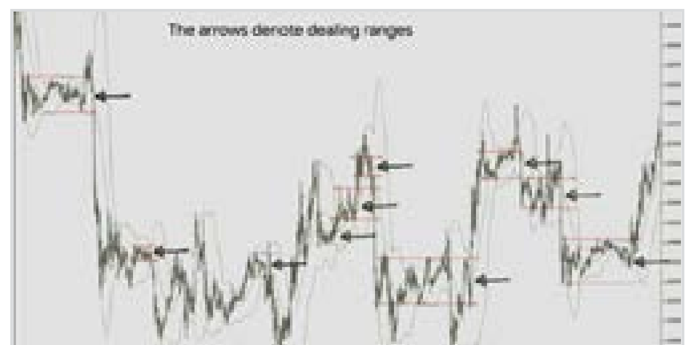
By sidestepping dealer traps and learning how to place your stop-loss in places that are difficult for the dealer t hit, you could add significantly to your trading bottom line

The first step to this is to understand dealing ranges

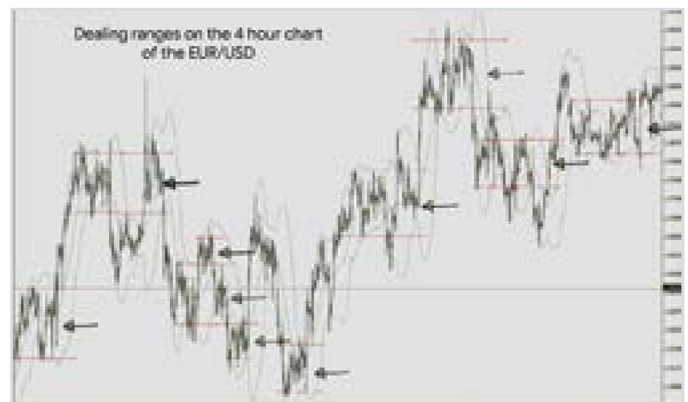
How dealing ranges influence the price

Dealing ranges drive market behaviour.

A dealing range is simply a high and a low for a trading session or a time period, such as day, week or month. Dealers use these levels to work out their orders and manage their positions. You can see examples of dealing ranges on the 15-minute chart of the EUR/USD here:



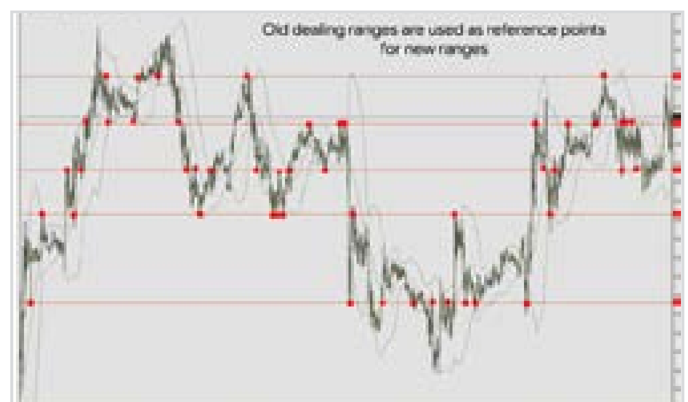
Dealing ranges exits on multiple timeframes. You can see the dealing ranges here on the 4-hour chart:



Dealing ranges are imprecise. The edges of the range are often pierced and the levels the dealers use for reference are fluid.

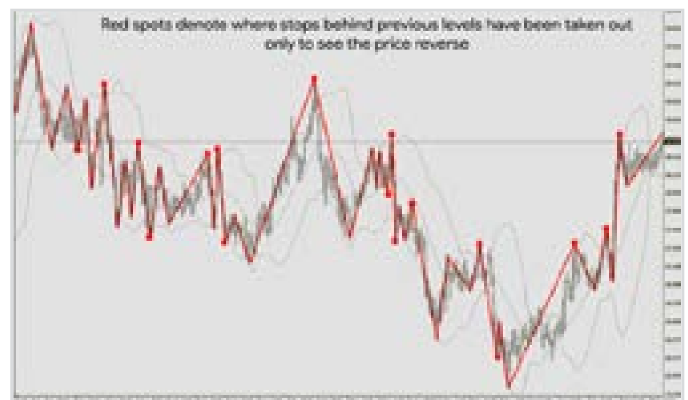
You will notice that an old dealing range will often form the basis for a new dealing range, i.e., they act as support and resistance levels. This is a type of market structure that is tradable and can provide you with an edge.

In the following chart you can see old ranges are used as reference points for new ranges which have been marked with a red dot.



Traders who are taught to put their stops behind support and resistance levels will often put their stop-loss orders behind dealing ranges. But the problem for these traders is that their stops then become a target for bank dealers. (This is also true of any major level.)

You can see this quite clearly on most forex charts. On the following chart, red dots mark where a move has taken out stops before reversing above or below either the dealing range or a support and resistance level.



You can see how often your stops would be taken out if you were not careful about your entry or where your stop-loss was placed.

So, the solution is simple, right? Widen your stops and don't put them so close to the edge of the dealing range.

Not so. There are other factors to consider first

Tight stops improve the risk-reward ratio of your trades

There is a problem with widening your stops.

Every extra pip you give away means that when you have a losing trade you will lose more, or when you win you will have traded a smaller size to compensate for the wider stop.

Both of these methods will have a negative impact on the risk/reward ratio of your trades. When you do win, you will make less than if you had a tighter stop. On the flipside, it could mean that you will have more successful trades to compensate for trades with lower profitability. By widening your stop, your win percentage improves.

Stop-losses are inextricably linked to your entry system and trade objectives

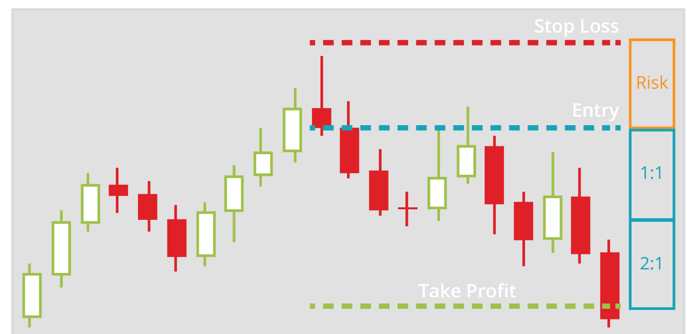
Your stop-loss should be a logical extension of your entry system and the objectives you have for the trade. For example, if you are a trend follower, looking to catch a breakout, you might have a tight stop-loss that you expect to get hit more often than not. Or, if your goal is to have a 3:1 risk/reward ratio on your trade, you will have a tighter stop that if you are going for 1:1.

Logically, choose a stop that fits holistically into your trading system.

Market types and stop-losses

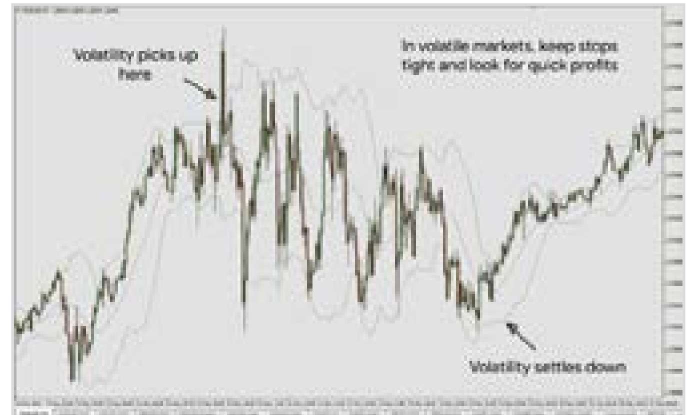
As the market types shift and change, so should your approach to the market.

This goes for stop-losses too. Consider if your stop-loss placement is suited to the current market type. In addition, be prepared to change your stop-loss if the market types change during a trade.



A note on volatile market types

Common wisdom espouses that during a volatile market type you should widen your stop-loss. We are of a different opinion. If the market type becomes volatile, you want to tighten your stop-loss. The markets have just got a whole lot more hairy and you don't want to give the market room to move against you. You will need to be prepared to be stopped out more often in this market type. However, by having tight stops, you will have the opportunity for some quick profits if things do go your way.



Superior options for stop-loss placement

You have four main considerations for stop-loss placement:

1. The dealing ranges
2. The risk/reward ratio
3. Your entry and trade objectives
4. The market type.

Understanding this, here are some different systems for placing stops that can help to improve the profitabilit of your trades.

CLASSIC SUPPORT AND RESISTANCE STOP-LOSS

The classic place for forex traders to place stops is behind support and resistance levels. Just be aware of the stop-hunting intentions of participants who can move the market. You could put your stop 7–25 pips beyond the level (depending on your timeframe), which will help you to avoid some of the whipsaws, but remember this will impact the risk/reward on the trade.

SHAKEOUT STOP-LOSS

This is perhaps a smarter way to place your stop-loss.

Wait until after the stops have been hunted and the price has reversed before you enter. Then place your stop-loss either directly behind the support or resistance level (or even slightly inside it) to improve the risk/reward on the trade.

On the following chart, you can see how once the stops have been taken out (the thin red line). It is now safe to place your own stop-loss (the thick red line).

INDICATOR STOP-LOSS

Indicator stop-losses can be quite useful for three reasons:

1. They give you a consistent place to put your stop that requires little discretion
2. They are (or should be!) relevant to your entry and trade objectives
3. The stop will not be in the usual place that dealers go a-hunting.

For example, you could put your stop-loss on the blue (100 period) moving average on the 15-minute chart of the USD/JPY, when you enter short on this moving average crossover system.

The dealer's worst enemy – the mid-air stop-loss

To avoid being a target for bank dealers, a mid-air stop is just the ticket. Mid-air stops are set at a far enough distance from the edge of the range to make it difficult for dealers to hit. If a dealer pushes too far out of th dealing range, they risk being picked off by other dealers, who gang up to drive the price against them. In addition, as your stop is likely to be on its own and not grouped with a bunch of others, there will be little point in dealers going for it anyway.

Mid-air stops work best when trading directly off support and resistance levels, since you can still maintain your risk/reward ratio. You simply place your stop far enough away from the dealing range that the dealers won't be interested in chasing it. It will look like it is hanging in mid-air, away from the action.

A special note on break-even stops

Break-even stops are a hot topic for traders.

There are both pros and cons for breakeven stops. Only you will know what is right for you.

On the one hand, a breakeven stop is a powerful psychological tool, helping prevent winning trades from turning into losing ones. It will increase, which can make it psychologically easier to follow your system and trade mistake-free.

On the other hand, if you move your stop-loss to breakeven, you may end up putting your stop in an illogical place that dealers can easily go for. In my experience, this can mean that although you have fewer losing trades, you will actually make less overall. The successful trades that you do miss out on will likely reduce the profitability of your system over time.

This means you are faced with a choice. Which is more important to you?

- Consistency; or
- Profitability.

So, what to do next?

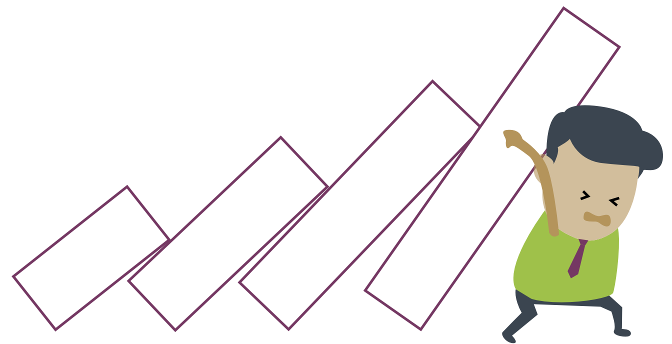
Simplicity is the ultimate sophistication.

LEONARDO DA VINCI

Now, it becomes a simple matter of testing. Try adjusting the following combination to see what suits your system:

- The risk/reward ratio by tightening and widening stops
- The stop-loss method.

Always think about the dealing ranges. Keep in mind where the market is likely to move to next and avoid putting your stop in places that are easy for dealers to hit.



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