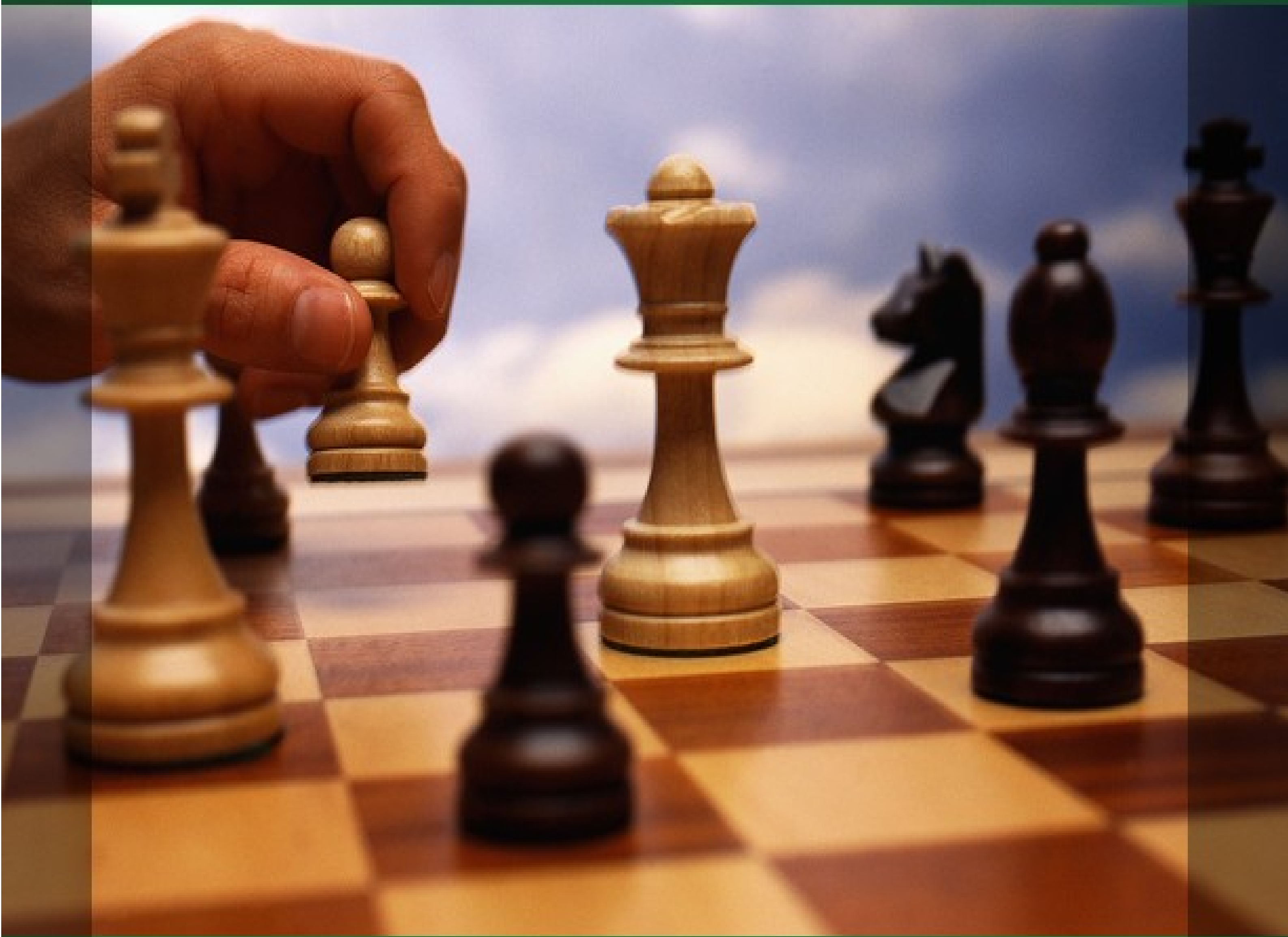
Forex Trading Strategy Mistakes



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Forex Trading Strategy Mistakes
3 X Common Trading Errors Which Cause Losses

We all know that 95% of all Forex traders lose money and most of these traders have no hope of winning because they base their strategies on principles that guarantee losses, which we will explore further in this article.

The mistakes are promoted as investment wisdom online by many vendors and gurus, and the reason for this is they make Forex trading success appear “easy”, and the naïve and greedy trader falls for the message and losses money.

When I started trading 25 years ago, most novice traders were making these mistakes and they are still making them today and probably always will. You need to avoid them, if you want to enjoy Forex trading success. So, let’s take a look at the strategy mistakes in more detail...

Strategy Mistake 1

Trying to Predict and Placing Stop losses Within Market Noise

One of the most common mistakes in a strategy is to try and predict Forex price turns in advance, which leads traders to think they can make money consistently with tight stops of around 30 – 50 pips but the bad news for these traders is - You Can't! The above so-called logic is incorrect, so let’s take a look at the error in more detail and look at how to trade correctly, with better risk control and better odds of success.

Why You Can’t Win Picking Tops and Bottoms with Tight Stops

Picking exact tops and bottoms is impossible but that doesn’t stop the losing Forex crowd, trying it again and again year after year, with the same result. They’re trying to trade to short term and seeing order in a day session most of the time (but all volatility in a day session is random) so trying to trade 5 minute or hourly charts is not a smart way to trade and no experienced trader would do it.

Fact: The Longer the Time Frame the Better the Odds of Success

The shorter the trading time frame, the greater the randomness and therefore the less reliable any trading signal will tend to be. When you are looking at a trading daily and weekly chart, you will notice random ‘noise’ but still see valid resistance and long term trends. However, when you're looking at a short time frame such as charts made of 5, 10 or 15 minute or hourly time frames you will generally see almost all the price changes are down to noise. We have run numerous back tests on this; you can do the same and will get the same result.

Prediction – Evidence that it doesn’t Work and a Popular Theory that Leads to Losses

There are plenty of people who tell you that Forex markets can be predicted and conform to some mystical order but they don’t; want the proof? Well think about it – if prices really could be predicted in advance, the market would cease to exist as we would all know the price before hand. Despite this being obvious, it doesn't stop a huge amount of traders believing in using Fibonacci retracements which are supposed to define some mystical support and resistance levels in the market. Before we look at the evidence that they don't work – let's look at the background to the theory to show just how ridiculous it is, in terms of trying to apply it to Forex markets to make money.

The Fibonacci Number Sequence

Leonardo Fibonacci was a brilliant Italian mathematician who lived in the 13th century and is known worldwide for his Fibonacci number sequence which has become very popular with Forex traders. Forex traders use the numbers, to calculate Fibonacci retracement levels to buy or sell into.

The Number Sequence

The Fibonacci sequence of numbers was first printed in the Liber Abaci, written by Leonardo Fibonacci back in the year 1202. The book was ground breaking at the time and introduced Hindu Arabic numerals which replaced the Roman numeral sequence.

A Question and an Answer

Most Forex traders don't know why the number sequence came to be. It was created to solve a mathematical problem which was based on the copulation of rabbits and posed the following question which needed to be answered:

How many pairs of rabbits will be produced from one single pair, if every month each pair produces a new pair, which, from the second month these rabbits will also start to reproduce?

The question was of course answered with the Fibonacci number sequence, the sequence is a series of numbers where each number is the sum of the two preceding numbers so we have - 1, 1, 2, 3, 5, 8, 13 etc.

The Discovery: The Golden Mean and Golden Ratio

After the first few numbers of the sequence it was noticed that the ratio of any number in relation to the next higher number in the series is approximately .618, and the lower number is 1.618 which leads up on to the Golden Mean or Ratio which is seen as showing natural order throughout the known world.

The two numbers above represent the golden mean or the golden ratio and there are several examples of the Golden Ratio which can be seen throughout nature and it's also believed that these numbers also order the financial world.

In terms of nature, sunflowers have opposing spirals of seeds which have a 1.618 ratio between their diameters. In a beehive, if you were to divide the number of female bees by the number of male bees, you will get a ratio of approximately 1.618. This same ratio can also be seen in many other areas from snail shells, to the weather and even can be seen in human DNA.

So what exactly has this ancient theory got to do with Forex trading?

Well, let's take a look at the rather laughable idea that you can make money trading currencies with it.

Applications in Forex in FX trading, (although the Fibonacci number sequence can be applied to any market) the ratios are derived from the sequence of numbers which are used to show levels in the market. These levels are considered important in terms of generating high odds trading signals, which are: 236, 50, 382, 618, etc. These numbers represent the Fibonacci retracement levels which traders can use to look out for levels of support or resistance in a currency pair. The two

Fibonacci percentage retracement levels considered the most valid are: 38.2% and 62.8% and other levels which are also used by traders to define support and resistance are the levels; 75%, 50%, and 33%. So according to this theory you can buy or sell into these levels and make money. But do they work?

Try it and you will soon lose your money. They work some of the time but so will any percentage. Most of the time they're of little use. However, they feed the retail Forex traders need to predict, and are immensely popular.

If Fibonacci were alive today, he would probably be highly amused by the way his theory has been taken over by the far out investment community and sold to a gullible public, to perform a function for which it was never intended. If you want to base your Forex trading strategy on a sequence that was originally designed to solve a question to do with the copulation of rabbits, go ahead but get ready to lose your account if you do.

A Point to Keep in Mind:

If you want to win, you need to stop predicting and try and get into and hold longer term trends and this means using wider stop losses. If you think this is too risky, then look at the leverage you're using! Most Forex traders leverage up too much and they take huge positions with tight stops and lose. The smart trader uses leverage wisely and can have a wider stop and still have great risk-to-reward. If you are a retail trader using more than 10:1 leverage, you're probably using too much so - cut leverage back and you will enjoy a better chance of winning and have a better risk-to-reward on your trades.

Strategy Mistake 2
The Inability to Get into or Hold Trends.

'For a market to trend it needs to deceive and shake-out the majority of traders'. (George Soros)

The smart traders are usually longer-term and trend following in nature. These traders will typically look to enter long at a reasonable price with good risk reward when the market is in an up -trend and then wait, for the trend to unfold to take a position and look to make a reasonable profit.

Inexperienced retail traders are looking for exact market timing and trying to trade the noise, they want to buy at a low and sell at a high and are constantly trying to predict every twist and turn of the market – what they don't understand is profits are made catching and holding trends - NOT trying to trade random volatility!

While there is a case sometimes to trade contrary, the best strategies to employ are not day trading ones but long term ones, such as trend following (looking for trends of weeks or months) or you can swing trade (looking for shorter term trends of around a few days to a week) either strategy will work and get the odds on your side.

Trends tend to continue because the retail trader is always trying to sell into strength in a bull market and buy into weakness in a bear market and he gets steamrollered. On the other side of the trend, the minority of smart traders are taking the majority of uninformed traders money.

Retail Forex traders as a general rule, are too short term in their view and they're generally wrong. Not only do they trade the wrong side most of the time, when they do get into a trend, they simply lack the discipline to hold onto it.

They tend to get excited when they make money and the bigger the profit becomes; the more tempted they are to take it. As open equity dips eat into their open profit, they decide to take a profit before it gets away and end up with a small profit which simply cannot cover the huge amount of losses they're taking trying to pick tops and bottoms - the result? They join the 95% of losers.

If you want to catch long term trends, you need to forget prediction and pinpoint market timing and just get in at a reasonable price and follow the trend. If you are trend following, you will have a lot of losses but the number doesn't matter – so long as you run your profits, which leads me on to the next point...

Strategy Mistake 3
Focusing on the Percentage of Winners to Losers

This is a common mistake and traders, actually think they can win more trades than they lose but as Bill Lipischutz, one of the most famous FX traders of all time stated, you need to figure a way to make money on around 30% of your trades!

If you want to enjoy long term trading success, you need to focus on the size of your winners and make them far bigger than your losers. I know very few top traders who make win more than 50% of the time and you don't need to have a bigger percentage of winners than losers because - the amount of trades you get right is not an issue in terms of making profits, it's the difference in size between your winners and losers which is the key to your FX trading profits.

It's human nature to want to be right all the time and there are plenty of vendors out there, who feed this human emotion of wanting to be right all the time. All these vendors are doing though is trying to sell junk systems, because they can't make money themselves.

How often do you see these statements?

- Trade with 90% accuracy or better
- Make a regular monthly income
- Make a 1,000% per annum with 0.5% draw down
- Ex Banker shows you how to beat the market
- Make Huge gains on autopilot
- Pinpoint Exact Market Turning Points in Advance

You will see the statements all the time, they're simply not true and any experienced Forex trader will tell you this. The naïve Forex trader will come to trade Forex thinking that the percentage of winners is more important than anything else and he doesn't think about losing. He soon gets a reality check though, as he takes loss after loss and when he gets a profit, he takes it in quickly and never lets it run.

How many traders do this? Plenty and they all end up losing their accounts.

These traders simply don't know how Forex markets work and end up losing their money quickly.

The Real World of Forex Trading

You can make a lot of money in Forex trading but you need to know the nature of the market you are operating in and adapt your strategy to it – NOT try and impose ideas on the market that are clearly not going to work. Most traders though want to trade the market on their terms and want "easy money" and their naivety and greed is fed by numerous vendors online.

These vendors have never traded in their lives or can't make money so they sell ideas about market behaviour which are simply not true. If you want to win at Forex trading, understand the market, understand the rules of play and abide by them and you can win, make the above strategy mistakes and you will lose all your money and do so quickly.

The mistakes though are easy to avoid and if you do avoid them and trade with a simple strategy with an edge, you can achieve long term success in trading global currencies for profit.

Best Wishes
Sasha
http://www.learncurrencytradingonline.com