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Turning Losing FOREX TRADES into Winners

PROVEN TECHNIQUES TO REVERSE YOUR LOSSES

GERALD E. GREENE

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To my most patient and understanding wife Sharon, who supports my passion for helping Forex Traders.

To all Forex traders who have lost money to the brokers and banks. Hopefully this manuscript will help each and every reader succeed.

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Foreword

If you use technical analysis, you are likely—or will be likely—to use candle charts. This is because candles can be used in any time frame and in any market, and they allow traders to spot turns before potentially large moves.

As the one who revealed this charting method to the Western world, it is gratifying to see its popularity. However, with the candle charts' universal availability and widespread use, there comes a downside—most traders are using them incorrectly. That is the reason my firm has such a strong focus on education (www.candlecharts.com/free-education).

One of the most dangerous and common misuses of candles is trying to use them as a stand-alone trading vehicle. This is wrong. Candles are a tool, not a trading system. This is why I also show how to combine candles with Western technical tools and to always incorporate risk/reward analysis.

Equally important is money management—that is, proper trade size. For example, what is the proper trade size to enter a position? How do you scale into or out of a trade? How do you adjust trade size for your risk tolerance level? These are important questions, but they are beyond the scope of my expertise. That is why I am pleased to strongly recommend this excellent book.

Based on working with some of the top institutional traders, I can tell you that many of the most successful ones have had more losses than gains. How did they accomplish this? The answer is by the judicious use of stops and proper trade size. So if you are picking up this book, congratulations: You have taken the first steps in following in the footsteps of such successful traders.

There is a Japanese Samurai saying, *"He whose ranks are united in purpose will be victorious."* By merging the timing advantages of candles with the discipline of proven money management as revealed in *A Trader's Money Management System*, you will become a more confident and successful trader. As an extra bonus, you will have less stress!

Steve Nison, president of Candlecharts.com
Author of *Japanese Candlestick Charting Techniques*
www.candlecharts.com

Acknowledgments

I would like to pay tribute to my friend and colleague Donald Snellgrove, who has probably done more than any other person in the world to help Forex traders. Unfortunately the Forex market is so very difficult to work with that most traders who attempt it do not succeed without help.

As a member of the Concorde Forex Group mentoring team, I have been personally associated with more than a thousand Forex traders over the past five years, and I have appreciated their sincerity and eagerness to learn. Our working together has contributed to my success and to the development of this manuscript. I have seen many Forex traders fail and give up. I have seen many Forex traders jump from one trading system to another in an attempt to succeed. They have taught me many things for which I am grateful. But, their struggle for success is the main reason for writing this book in order to assist them and all other Forex traders who need to know how to manage the losing Forex trade.

Introduction

Most trading systems and methodologies that I have been exposed to are able to achieve 80 percent success at their best. In any market there is a reason for this as conditions change without prior notice. The market for any product or currency alternates between three stages that I will call trending, channeling, and transitioning. A market is trending when it is moving consistently in one direction. A market is channeling when it is bouncing between levels like a ping-pong ball. The periods between these two major stages is the transitioning market. It is difficult for the trader to be good in all of these conditions. Trading systems tend to do well when the market is trending, but then fail during the other two stages.

I remember talking to a trader during a Forex trade show who described how his professional money manager had built up his account over 60 percent the previous year. However, during the 90 days leading up to the trade show, he had many losing trades, and the account balance had returned to the previous level. I immediately knew what had happened. The U.S. dollar was trending during the previous year, and now it was not. This was the same trade show where two companies introduced their new automatic trading software, which is always exciting to contemplate. During discussions with the two firms, they admitted that the current quarter was not working very well, and that they were suffering losses. Again, the current quarter was not a trending one, and they were suffering as a result. These trading systems could not accommodate the different stages. The market makers are ruthless, and they are always looking for easy money—yours.

Remember the Seinfeld episode where George convinced Jerry to buy stock based upon an inside tip? Well, the stock went down and reached Jerry's 50 percent level, so he panicked and bailed out. You can guess the rest even if you did not see the episode. Sure enough, within a few days the stock went up reaching Jerry's 150 percent level, and he was distraught. I know that you are thinking that it reached the Fibonacci 50 percent level and then resumed its upward course. But, if you look at your charts carefully, you will find that these Fibonacci levels are close together, and if you use the word “approximate” the reversal can take place at almost any level. Traders look back and identify the reversal point with authority, and wonder how they missed that wonderful technical indicator. If you trade the 50 percent levels every time they are reached, however, you will not be successful.

There are many trading advisors who have ideas regarding the selection process and how to pick the right times to trade retracements, but overall, it is difficult to exceed the 80 percent success rate.

Trading systems work with the obvious two choices:

1. When to enter the market in the same direction
2. When to enter the market in the opposite direction

So, if you are trading a system carefully or just anticipating with your gut, you will benefit from tactical knowledge for what I call “cost averaging.” Average the results of one bad trade followed by one good trade. Leave behind the emotional baggage of a bad trade and then be ready to take advantage of the market cycles at the right moment to offset losses, either partially or completely.

Whether your trading system is based upon fundamental knowledge of economics or on charting technical analysis doesn’t matter. You will occasionally find yourself with open trades that are not working, and at that point I can help you take advantage of market conditions to improve your position.

“How can I succeed when my trading will not be 100 percent right?” If you have this question in your mind, then this book is for you. I will describe a method for you to analyze difficult trading situations. I will not attempt to alter your trading style or trading system, but I will help you understand how to get out of a trade that is not working for you and how to recover from many losing situations.

CHAPTER 1

Trading Systems

The number of Forex trading systems available today is very large. The Internet contains descriptions of each one with promises of untold wealth awaiting the trader who uses it. An obvious question arises in our minds: “If each one works, then why did someone need to develop the next one?” During the past six years I have worked with many hundreds of Forex traders who have struggled to find a method of trading that works for them. I am not a psychologist, but it seems to me that trading systems, or styles, need to match the personality type. It is amazing to observe this in action. There are people who can trade specific systems with ease, while others just cannot make it work for them. The same trader will move to a different trading system and suddenly succeed. Some traders keep looking, while others give up, but the persistent seeker usually finds a method that fits, which results in a positive trading experience. So, the beginning trader faces two challenges. The first is to identify a trading system that matches his/her personality, and the second is to master the system itself. Over the years, the people group that I have seen struggle the most with trading systems are male engineers. They have two issues to deal with. First, they are engineers because they like to find better ways of doing things. Their first self-appointed task is typically to find a way to improve any trading system that they are attempting to learn. Instead of following the system, and learning how to use it, they work on the system itself, and postpone for a later time learning how to trade it. And, of course, because they are males, they hesitate to ask for directions. Based upon what I just said, you can guess that women make good traders because they are willing to follow directions. Yes, I believe that to be true.

TRADER AUDIT

The simplest way to determine if the system is working for you is the net profit/loss statement. There is, however, another important measurement that every trader should make at least once a year, and that is what I call the "Trader Audit." The Trader Audit is a simple examination of losing trades. I recommend that you review your trade history for the last 12 months and list a sample of the losing trades. The sample size is subjective, but should contain at least a dozen losers. Write them on a sheet of paper, or use a computer spreadsheet, leaving space for five columns of information to the right of the trade. Record the currency pair, entry date and time, entry price, close date and time, close price, and pips per lot lost. When this is completed, add the headings for the new information to the right of the pips lost data. The five new headings are +10, +20, +30, +40 and +50. The purpose is to evaluate the Forex history and determine the outcome if the stop loss value for these losing trades had been larger. Quite often traders who are entering at the right time are also setting the stop loss incorrectly, and not giving the Forex market enough room to breathe. By reviewing the history, and filling in the new values of profit/loss with the larger stops, it is easy to recalculate the overall profit/loss. So, when the numbers are entered in each column, the next step is to calculate the total for each new column. If any of the right-most five columns renders a higher overall profit, then it is clear that larger stops would have been better. If none of the right-most five columns renders more profit, then the trades were "bad" entries to begin with.

This simple exercise helps the trader to identify the area that requires the most improvement. Either way, you can use this study to guide your efforts moving forward. You can readily understand why this audit should be performed on a regular basis. Not only do we sometimes get lazy, but the Forex behavior also changes from year to year. In Figure 1.1 the first entry was stopped out with a 25 pip loss. If the stop loss had been set 10 pips higher, the trade would have been successful. The second example is different, and shows that the stop needed to be 20 pips higher. I can conclude that if my stops on these two transactions were just 20 more pips than I used (see P20 column), it would have made a 92-pip difference per lot to the account balance. Using this technique, you will be able to determine if your stops are too tight.

CURRENCY	OPEN	ACTION	CLOSE	PRICE	LIMIT	STOP	LOSS	P10	P20	P30	P40	P50
EUR/USD	Mar 28 04:00	SELL	Mar 28 10:00	1.3337	1.3317	1.3362	-25	20	20	20	20	20
EUR/USD	Apr 08 08:30	BUY	Apr 08 12:30	1.3398	1.3415	1.3368	-30	-40	-50	17	17	17
TOTAL							-55	-20	-30	37	37	37

FIGURE 1.1 Trader Audit

BROKER CONSIDERATIONS

One of the things that each trader needs to understand is that the broker needs time to move money when it is traded. For example, if a trader enters a buy on the EUR/USD for 10 lots, and the market is moving and it goes up three pips within two minutes, and then the trader closes the trade, the broker can be caught with the money stuck in his system. That is, the broker might not have been able to pass the transaction through to a bank, and it is caught with the loss. Brokers do not like "scalpers," which is what I just described. They want traders who will remain in positions long enough for them to clear the transaction, especially if the trader is trading a "mini" account which uses non-standard size lots.

Mini account trades need to be accumulated by the broker until a standard lot size is reached, and then a transaction can be made with a bank. The broker computer software is becoming more sophisticated and is able to evaluate customer accounts to identify scalpers. If they determine that a customer is causing them to lose profit, then they will take action to prevent future losses. The landscape is changing, however, whereby the banks are developing computer systems that allow them to offer trading directly to the retail customers. But, the banks are just as sensitive to the issue of scalping. The Forex broker might be an endangered species as banks become more aggressive and offer retail services.

Some brokers have very lean operations that involve a small support staff and a computer server. For example, a broker can license the MetaTrader© (Copyright MetaQuotes Software Corp.) trading platform and outsource the server to a firm that specializes in this platform. It is a simple process, and requires little or no skills, and no software engineers. Standard software interfaces are used to connect to banks, and the broker is in business almost overnight. But, mini accounts need to be handled separately, so there is a software interface to allow for this. The broker can have its own dealing desk where partial lots are accumulated and traded with the banks, or the broker can use the software to give this business to another broker who has a dealing desk. You would be amazed at how much consolidation has developed, and how much business ultimately goes through very few dealing desks.

FUNDAMENTALS

The system of trading that relies on the fundamental economic factors is a sound one. There is no voodoo there. It makes sense, but it requires full knowledge of all of the factors, and it requires very fast analysis as daily announcements are made. It is amazing to watch the Forex in action when the various governments make an announcement. The larger banks have predefined tables of what they will do based upon the expected economic values to be reported. However, when the numbers released are unexpected, then large market swings occur. I know of one trader who trades a large number of lots with a Swiss bank, and who trades the fundamental announcements. He claims a success rate of over 90 percent. He says he has a fast finger, and enters his trades very quickly with very good results. I don't know about this. If you were the banker and at the end of the year evaluated his trading account and had your computer prepare a profit and loss statement that showed commissions gained, but also showed that every time you sold to this guy the bank lost potential profits within seconds, you would probably ask him to take his business elsewhere.

There is, of course, the basic way to trade fundamentals that entails a larger view. If you determine that the U.S. dollar will weaken over the next year, and enter a long-term trade accordingly, then this is a good thing. But most Forex traders are short-term traders, or what we will call Day-Traders. When trading with high leverage of 100 or 200 to 1, one needs to be very accurate.

TECHNICAL TRADING

My first entry into the stock market was a primitive form of technical trading. I was involved in the medical surgical instrument business, and we sold several patented products that we developed, plus others that were developed by physician partners. In the course of our business a competitor emerged with what I thought was a better product than one of ours. After we sold our business to a larger firm that was listed on the NYSE, I began to purchase this ex-competitor's stock. I would look at the daily chart on the Internet and place orders to buy whenever the stock price dipped. This would result in almost one transaction per day as I would buy the retracements and sell the recoveries. The stock price did not move that much, but the price was small and the percentage of movement was correspondingly large, and because it was a new and effective surgical product that was not subject to economic recessions, I knew that the overall trend was upward. I congratulated myself for doing so well.

After three months the stock prices moved differently so I stayed out of the market to wait for a better price, and one day the price jumped and nearly doubled. This was my first lesson in the weakness of technical trading. The fundamental trader would have been more patient.

My next trade was more fundamental. I found a female hormone therapy product that was made from natural products. It was designed to