

1. An overview of the markets

To begin with

So you want to be a trader but have no idea what to trade, how to trade, or where to trade?

This is a good place to begin.

By the end of our trading academy, you'll be well-informed, enlightened, and ready to begin trading for real money.

Let's get down to business: if you want to trade the financial markets, you must first understand what they are.

Don't worry if you're confused or unsure; you may know more than you think. The stock market, capital markets, and even just the markets are all names for the financial markets. Simply put, the financial markets are places where buyers and sellers can trade assets.

There are various types of markets, various types of participants, various products, and even various types of investors. To fully comprehend the markets, it is necessary to comprehend all of the players involved.

Financial Markets

The financial markets are essentially a "global flow of money chasing money."

There are three Main Global Centers in the world: Tokyo, London, and New York.

There are also FOREX & Money Markets, Equities, Commodities, Fixed Income & ETF Markets, and Emerging Markets.

Exchanges are where these various products are traded. The NYSE, for example, is one of the most well-known exchanges (New York Stock Exchange).

Participants in the Market

Now that you've got a basic understanding of what financial markets are, let's look at the institutions and corporations that create them.

The following are a list of the major market participants:

Retail and investment banks are examples of commercial banks.

Electronic and voice brokers are examples of brokers.

Corporate and Investment Institutions, such as Pension Funds and Hedge Funds, are examples of institutional investors.

Central banks, such as the Bank of England (Bank of England)

Product Types

Let us now look at what is actually traded on the financial markets.

There are essentially two types of trading methods;

The first is Exchange-Traded Funds (ETFs).

Trading that takes place on a centralised, highly regulated exchange

Example:

NYSE stands for New York Stock Exchange.

NYMEX-COMEX is an abbreviation for New York Mercantile Exchange - Commodity Exchange.

CME stands for Chicago Mercantile Exchange.

CBOT is an abbreviation for the Chicago Board of Trade.

LSE is an abbreviation for the London Stock Exchange.

LME stands for London Metal Exchange.

IPE stands for International Petroleum Exchange.

The second type of trading is over-the-counter trading (OTC)

A security traded on an exchange, usually between banks via a dealer network.

Interbank currency markets, derivatives markets, and bond markets are a few examples.

Investors of various types

Which type of trader are you? There are several trading styles, and most traders fall into one of the two categories listed below.

Hedger - A person whose primary motivation is to reduce the risk of adverse price movements in a security rather than to seek profits.

Speculator - A person who seeks large profits in exchange for large risks by attempting to predict price movements in the hope of making large, quick gains.

2. What exactly is CFD trading?

Example of CFD Trading

CFDs are frequently traded using leverage [don't worry, we'll get to that later] to give traders more trading power, flexibility, and opportunities. For the time being, let's stick to the basics with the following example:

The Arrangement:

Person A believes gold will rise from \$1175 per ounce.

Person B believes gold will fall from \$1175 per ounce.

As a result, the two clients reach an agreement to settle the difference of \$1175.

Person A purchases 1 oz of gold at \$1175; Person B sells 1 oz of gold at \$1175

After three days, gold is trading at \$1180, resulting in a \$5 profit for Person A and a \$5 loss for Person B.

Person A sells the position for \$1180 and earns \$5.

Person B closes the position at \$1180, incurring a \$5 loss.

That example makes CFDs appear simple, which is because they are. Trading CFDs is not dissimilar to trading traditional shares.

If you purchase 500 shares of a company for £5, you will have £2500 in stock.

If you buy 500 shares using a CFD at £5, you will also have £2500.

If the share price rises by 10%, you will have profited £250 from your share trade.

If the share price rises by 10%, you will have profited £250 from your CFD trade.

You may be wondering why you should trade CFDs if the value is the same, the profit is the same, the loss is the same, and the risk is the same.

To learn more, see "Advantages of CFD Trading" below.

Profit and Loss Calculations are one of the benefits of CFD trading.

A CFD's profit or loss can be calculated using a simple formula.

$P/L = (\text{Sell Price}^* - \text{Buy Price}^*)$ multiplied by the number of CFDs

*Instead of a decimal point

The profit on a CFD is the difference between the buying and selling prices, regardless of whether you bought or sold first. It's really that simple!

The remainder of this document contains numerous examples of P/L calculations.

Profit from a declining market.

CFDs allow you to profit whether an instrument's price is falling or rising. As previously stated, there are no restrictions on opening a position in CFD trading with a buy or a sell.

Entering a position with a buy-sell, as you would if you thought the market was falling, is known as short selling, and it allows you to sell a position first and then repurchase it at a lower price.

Here's an example using our simple P/L formula:

...and it does so in order to complete your transaction...

You purchase ten CFDs at a price of 58.85.

$$(6030-5885) \times 10 = \text{P/L}$$

$$= 145 \times 10 \times 10 \times 10 \times 10 \times 10$$

\$14,500

Trade on a variety of markets

CFDs do not limit you to a single asset class; you can trade all of your favourites with CFDs. Accuindex Markets allows you to trade CFDs on:

Commodities Indices Bullion Foreign Exchange (Forex or FX)

There is no stamp duty.

When you buy a share, you must pay the government 0.5 percent of the transaction's value. CFDs, on the other hand, do not require any stamp duty; unlike other investments, there is no stamp duty to pay on a CFD trade.

Margin liability

CFDs are traded on what is known as margin. This means you can enter the market with a large position without having to deposit the entire contract value.

Accuindex Markets, for example, provides 400:1 leverage on FX, which means that a \$2,500 deposit can be leveraged to trade \$1 million!

Later in our training, we will go over some worked examples of margin and leverage.

But for the time being, all you really need to know is that leverage is a very efficient use of capital and frees up your equity to trade in other transactions

The Potential Pitfalls of CFD Trading

Trading CFDs can be risky; as previously said, leverage allows you to acquire positions larger than your initial deposit. This means that you can possibly earn enormous gains but also face a larger risk of large losses.

If you are a beginner, the most critical aspect is risk management. Indeed, risk management is critical enough that we've dedicated an entire module to explaining how to accomplish it.

The Three Major Market Categories

Bullion is Gold and Silver, and the demand for Bullion is driven not only by its practical use, but also by its role as an investment and store of value. Paper currencies have a number of drawbacks, including the risk of being inflated during times of political and economic turmoil, which can have a negative impact on their investments. Gold and silver are safer bets in this regard because their value isn't dependent on the health of any particular government, so issues like inflation and economic downturn don't have as much of an impact.

Because you do not take delivery of Gold or Silver when trading Bullion via a CFD, the difference in price between the buy and sell price is settled in cash.

Factors influencing bullion prices

The price of gold and silver, like the price of almost all other investments and commodities, is determined by supply and demand. Given that the majority of the gold and silver ever mined still exists and can thus potentially be reintroduced into the market, changes in sentiment will affect the price more than changes in production or jewellery demand.

Economic Aspects

When there is significant inflation and interest rates are relatively low, investors will seek the safe haven of bullion to protect their capital during times of low or negative real interest rates.

War: During times of great uncertainty, particularly when war is feared, demand for bullion rises as investors see bullion as a solid investment with a stable value in any country.

Sentiment: It was once said that "gold is the world's scared bunny." When a crisis threatens, demand for physical bullion rises.

We quote bullion beginning at 23:00 Sunday London time and ending at 21:00 Friday London time. During this time, we offer Bullion prices 24 hours a day, except for a daily exchange break from 22:00 to 23:00.

Indices

A stock market index is a list of stocks as well as a statistic that reflects the total value of its components. It is essentially a fictitious portfolio of securities that represents the entire market, a portion of the market, or the best performing segment of the market. All of the stocks in an index will have something in common, such as belonging to the same industry, and the index will serve as a tool to represent the characteristics of all of these stocks.

There are also specialised indices, which allow you to track the performance of a specific sector, but more often than not, the indices that will be offered are the broader indices that cover the market's major stocks. A broad-based index reflects investor sentiment on the state of the economy by representing the performance of an entire stock market. Indices may sound complicated, but you've probably heard of them; the most commonly quoted market indices are made up of stocks of large companies listed on a country's largest stock exchanges, such as the American Dow Jones Industrial Average and S&P 500 index, the British FTSE 100, the French CAC 40, the German DAX, the Japanese Nikkei 225, and the Hong Kong Hang Seng Index.

Indicators' Influencing Factors

An index reflects the overall health and stability of a country's economy and is influenced by the country's industrial and political status. It is important to remember that a country's index is directly related to the relative strength of that country's currency, because a company's competitiveness on the international stage is determined by its currency.

Factors of Industry

The difference in the monetary value of exports and imports over a given time period is known as the trade balance. A positive balance is known as a trade surplus, and it indicates that more goods were exported than imported. The inverse is referred to as a trade deficit. The key figure here is the export figure, because an increase in this indicates either a strengthening competitive position at home or a strengthening economy overseas, both of which are boosting domestic growth.

Manufacturing, mining, and utility output are all highly sensitive to consumer demand and interest rates. As a result, when forecasting economic performance and growth, Industrial Production is critical. In fact, it is so important that central banks use it to measure inflation because high levels of industrial production can lead to uncontrolled levels of consumption, which leads to inflation.

Relative Currency Strength: This determines a company's ability to compete in the international arena. If the home country's currency is strong, wages and production costs will rise, and in order to make a profit, the cost of the final product will rise as well.

Political considerations are critical. For many investors, political and social stability in a country, government policies, the regulatory environment, and central bank intervention are all intertwined with economic conditions when making investment decisions.

Indicates after-hours pricing

Market makers, such as Morfin fx Markets, frequently have prices that differ from the prices quoted at the exchange. This is due to the fact that the underlying contract will be a future, and we, for example, offer a rolling spot product. Fair value is a concept that is used to convert an index futures price into an equivalent spot price by removing the cost of carrying effect involved in the price [such as dividends, interest rates, and so on].

If the concept of fair value is still unclear to you, perhaps the following example will help;

The last trade on the LIFFE FTSE is 6850.

The fair value is -10.

The market maker's price is between 6839 and 6841. (built with a 2 pip spread around the new cash price of 6840)

The dealers monitor these fair values to ensure that our prices are relevant to the futures market. You should also keep in mind that our prices may differ from those quoted in the cash market on Bloomberg, Reuters, or any other reference source. This is due to the fact that the cash price is derived from a weighted average of the prices of the constituent stocks. If a stock in an index is suspended or not trading correctly, this can make a difference. Because Accuindex is a tradable instrument based on another traded instrument, its price is more accurate.

Exchange Rates

The Foreign Exchange market (also known as the FX, Forex, or currency markets) is the world's largest, with an average of approximately \$3.0 trillion in currency traded every day. The market exists wherever one currency is exchanged for another and is comprised of transactions involving large banks, central banks, currency speculators, multinational corporations, governments, and other financial markets and institutions. The foreign exchange market is an OTC (Over The Counter) market in which participants trade over the phone and through computer connections. Accuindex Markets is one of the market makers that provide their own prices derived from reputable counterparty feeds. We do not physically deliver currencies, but rather provide them on a contract for difference basis, allowing clients to speculate on the relative strength or weakness of one currency versus another.

FX rate influencing factors

Floating exchange rates are constantly changing and are influenced by supply and demand for each currency, just like any other product. The factors that influence supply and demand can be divided into two categories: economic and political.

Economic Aspects

Relative Interest Rates: An interest rate is the rate of return on a loan made in that currency. It follows that if an investor can earn only 3% in his home currency but 6% in a foreign currency, he can increase his return by exchanging his money for the foreign currency and lending the money. The currency with the highest interest rates will tend to strengthen/appreciate as demand for it grows.

PPP: Purchasing Power Parity (PPP) is a measure of how much equivalent goods cost in two different currencies. If the EUR/USD exchange rate is 1.1200, and the same car costs €8,000 in France and \$11,000 in America, it would be cheaper for someone in the US to import the car from France (ignoring the cost of importing, tariffs, and so on), as it would only cost $€8,000 \times 1.12 = \$8,960$. As a result, the country with the lower domestic PPP will tend to weaken/depreciate as consumers seek cheaper foreign goods and, as a result, exchange domestic currency for foreign currency.

Economic conditions: If investors see opportunities to invest in a specific country, they will exchange their domestic currencies for that country's currency, increasing demand for the currency and thus the exchange rate. The factors that influence international investors' perceptions of favourable conditions are complex and multifaceted, but they include GDP growth, inflation, and taxation conditions.

Political Aspects

For many investors, political factors are intertwined with economic conditions when making investment decisions, and include things like a country's political and social stability, government policies, regulatory environment, and central bank intervention.

Hours of Operation

From 22:00 Sunday London time to 22:00 Friday London time, we quote Foreign Exchange prices. During this time, we offer prices in currencies 24 hours a day, seven days a week.

When you decided to learn more about trading, you probably had one of these three market categories in mind. If you're still unsure, or simply want to learn more about FX, proceed to the next module, which is entirely dedicated to the Foreign Exchange Market.

3. What exactly is Forex?

Forex

FOREX is the world's largest financial market in terms of both size and liquidity. To give you a sense of scale, an estimated \$5 trillion is traded globally each day. No other stock market in the world trades such a large amount of money on a daily basis.

The concept of FOREX is straightforward: it is the exchange of one country's currency for the currency of another. Because FX involves the purchase of one currency and the sale of another, it is natural that FX is traded in pairs such as the pound and the US dollar [GBP/USD]. Some "FX pairs" are more popular than others, such as the Euro versus the US Dollar [EUR/USD], the British Pound versus the US Dollar [GBP/USD], the US Dollar versus the Japanese yen [USD/JPY], and the US Dollar versus the Swiss Franc [USD/CHF]. These four popular currency pairs are known colloquially as "the Majors."

At almost any time of day, a financial centre somewhere in the world is open for business. The foreign exchange market is open 24 hours a day, seven days a week, and only closes on weekends between 22:00 (GMT) on Friday and 22:00 (GMT) on Sunday.

The Foreign Exchange market is homeless, which means it has no fixed physical location. OTC [Over-the-Counter] markets are homeless markets in which all trades are processed electronically 24 hours a day between banks all over the world. Forex, unlike other financial markets, lacks an exchange centre, so you can trade FX from anywhere in the world at any time, though there are some peak trading session times in each region. We've provided a general outline below:

Forex quotes

As previously stated, currencies are always traded in pairs; this is because when you buy one, you are essentially selling the other, and vice versa.

So, how do you interpret an FX quote?

For example, $\text{EUR/USD} = 1.1200$.

This means that 1 € equals 1.12 \$.

EUR is referred to as the base currency in this quote.

USD is known as the counter or quote currency in this quote.

This quote is also known as a direct quote because the counter or quote currency is the US Dollar.

For example, $\text{USD/JPY} = 125.00$

This means that one dollar equals 125 cents.

USD is referred to as the base currency in this quote.

JPY; in this quote, JPY is referred to as the counter currency or quote currency.

This quote is also known as an indirect quote because the base currency is the US Dollar.

The Bid, the Ask, and the Spread

All forex quotes include two prices: a bid price and an ask price.

The bid price – If you want to SELL the base currency, you would click on the bid price.

The bid price is the price at which the other party is willing to buy the base currency you want to sell in exchange for the quote currency.

The asking price – If you want to BUY the base currency, you would click on the asking price.

The asking price is the price at which the other party is willing to sell the base currency to you in exchange for the quote currency.

The BID price is always lower than the ASK price, and the difference between the two is known as the SPREAD.

The spread is the price difference between buying and selling the base currency; this difference is charged to the client and paid to the Market Maker.

Going Long or Short

Going long or short is simply trader jargon for buying or selling.

You're halfway there if you remember LONG = BUY and SHORT = SELL.

The following section is a little more difficult...

When it comes to FX, it's important to know when to go long and when to go short.

In FX terms, "going long" means buying the base currency and selling the quote currency. It is what you would do if you expected the base currency to rise.

For example, EUR/USD = 1.1200.

If you thought the EUR was going to rise, you would "go long," which means you would buy EUR with the expectation of selling it for a higher price once it had risen.

You decide to go long on the Euro at 1.1200.

The value of the euro rises; EUR/USD = 1.1400

Your Euro is now worth \$1.14 rather than \$1.12.

In FX terms, "going short" means selling the base currency and buying the quote currency. It's what you'd do if you thought the base currency was going to fall in value.

For example, EUR/USD = 1.1200.

If you thought the EUR was going to fall, you would "go short," which means you would sell it in the hope of being able to buy it at a lower price once it had fallen.

You sell the Euro at 1.1200.

The value of the euro falls; EUR/USD = 1.1000

Your Euro is now worth \$1.10 rather than \$1.12.

Keep an eye on your pips as they grow into much more.

You've probably heard the terms "PIPs" and "LOTS" a million times; they may be small, but they're big in the trading world. You won't be able to understand trading unless you first understand them.

What the f*ck!?

PIP is an abbreviation for "percentage in point," and it refers to the smallest possible increment in a quote.

For example, if the GBP/USD rate is 1.5696, a PIP would be 0.0001.

With a USD/JPY rate of 123.45, a PIP here would be 0.01.

So a PIP is essentially the last decimal place of quotation; most currency pairs will have a PIP of 0.0001 because they are typically quoted to four decimal places. However, as the preceding example shows, this is not always the case.

What is the definition of a lot?

Standard lots and micro lots are two of the first concepts you should learn as part of your Forex trading training. What are they and what is the difference between them?

What exactly is a Forex lot?

A standard forex lot is equal to 100,000 of the base currency, so EUR 100,000 in the case of EUR/USD. The average pip size for a standard lot quoted to four decimal places is ten of the counter currency, or \$10 in this case. On a standard EUR/USD contract, a loss of 10 pips equals a loss of \$100.

Pip Movements (for example, EUR/USD at 1.28205):

$P\&L = 100,000 \text{ (1 Lot)} \times 0.00001 = \1.00 5th Decimal Place (Micro pip movement)

$P\&L = 100,000 \text{ (1 Lot)} \times 0.00010 = \10.00 4th Decimal Place

$P\&L \text{ in the third decimal place (10 pip movement)} = 100,000 \text{ (1 Lot)} \times 0.00100 = \100.00

$2\text{nd Decimal Place (100 pip movement (Big Figure))} = 100,000 \text{ (1 Lot)} \times 0.01000 = \$1,000.00$ Profit and Loss

$P\&L \text{ for the first decimal place (1,000 pip movement)} = 100,000 \text{ (1 Lot)} \times 0.10000 = \$10,000.00$

Pip Movements (for example, USD/JPY @ 76.850):

$Y100 = 100,000 \text{ (1 Lot)} \times 00.001 = 3\text{rd Decimal Place (Micro pip movement)}$

$\text{¥}1,000 = 100,000 \text{ (1 Lot)} \times 00.010 = \text{2nd Decimal Place (1 pip movement)}$

$\text{¥}10,000 = 100,000 \text{ (1 Lot)} \times 00.100 = \text{1st Decimal Place (10 pip movement)}$

$100,000 \text{ (1 Lot)} \times 01.000 = \text{¥}100,000 \text{ for a big figure move.}$

Let's look at another currency pair, USD/JPY. Because USD is the base currency, the standard lot size is \$100,000. Because USD/JPY is only quoted to two decimal places, a pip is equal to JPY 1,000, so if you are up 10 pips on a standard USD/JPY contract, you have made JPY 10,000.

Standard lots of forex are typically reserved for institutional-sized accounts; we're talking about high rollers with \$25,000 or more to make trades using standard lots.

What exactly is a Forex lot?

So, let's be honest: if you want to get into Forex trading, you should start small and work your way up. Micro lots are ideal for beginners who need to learn the ins and outs of Forex trading. In contrast to standard forex lots, which are worth \$100,000 of the base currency, a micro lot is worth \$1,000 of the base currency you want to trade. Similarly, unlike standard lots, where 1 pip equals 10 of the counter currency on pairs quoted to four decimal places and 1 pip equals 1,000 on pairs quoted to two decimal places, 1 pip in a micro lot is only worth 0.10 (4 decimals) or 10 (2 decimals) of the counter currency.

Margin and Leverage

Now that we know what a pip is, we can see that it is a teeny-tiny amount, so you need to trade a LOT for these tiny PIPs to make a difference.

'By allowing you to control a relatively large asset for a fraction of its cost, you can magnify your profit potential while risking greater losses.'

For example, a 0.25 percent margin deposit means you are trading 400 times leverage; buying 1 lot of GBP/USD @ 1.2900 with a 0.25 percent margin requirement will cost you \$322.5.

The margin requirement means that you can trade in the market with a volume of \$100,000.

Leverage trading allows you to profit from very small pip movements in the market by trading in large volumes. Don't worry if you don't fully understand "Leverage" yet; we'll go over it in more detail in later modules.

Calculating your Profit and Loss in the Market

Show me the money!

Now that you understand what a pip is and what a lot is, you need to know why you learned about them in the first place.

We need pips and lots to work out our profit and loss; so here are the basics of your Ps and Ls.

Remember how we spoke about DIRECT and INDIRECT Forex quotes before? Well here's where you can put your new knowledge to work!

There are two rules for calculating your profit and loss in forex, and it's all about the dollar

Whenever you have a direct quote [where the quote currency is USD] you can calculate your profit and loss by using the following formula

$$P/L = (\text{SELL PRICE} - \text{BUY PRICE}) \times \text{STANDARD LOT SIZE} \times \text{NUMBER OF LOTS}$$

Remember that the standard lot size is \$100,000 and for mini lots, the standard size will be \$10,000

Example: You buy 2 lots of EUR/USD at 1.1205 and sell at 1.1210

$$P/L = (1.1210 - 1.1205) \times 100,000 \times 2 = \$100$$

Whenever you have an indirect quote [where the quote currency is NOT USD] you can calculate your profit and loss by using the same formula.

Example: You buy 1 lot of USD/AUD at 1.2917 and sell at 1.2932

$$P/L = (1.2932 - 1.2917) \times 100,000 \times 1 = \mathbf{150 \text{ AUD}}$$

CAREFUL: the profit figure stated here is in AUD, not USD. It is important to remember that with indirect quotes (where USD is not the quote currency) you need to convert the profit and loss figure to USD by dividing by the relevant exchange rate.

You have 150 AUD; divide by the selling price [because you're selling AUD and buying USD]

$$150 \text{ AUD} / 1.2932 = 115.99 \text{ USD}$$

4. Analysis

The Technical vs. The Fundamental

Traders use both technical and fundamental analysis to help them decide on a trading strategy. Fundamental and technical analysis both assist traders in forecasting possible trends and future prices.

Technical analysis is defined as "the process of analysing a financial instrument's historical prices and other market activity statistics in order to predict probable future prices."

Fundamental analysis is defined as "the determination of price based on future earnings – it focuses on factors such as the overall state of the economy, interest rates, production, earnings, and management."

Here's how it's put simply:

Technical analysis uses past asset prices to forecast future prices, whereas Fundamental Analysis believes that market movement is determined by macro and microeconomic factors such as interest rates, war, political unrest, recession, global economic depression, and so on.

The fundamentalist primarily studies the cause of market movement, whereas the technician primarily studies the effect.

You've probably got a million questions running through your head.

"Which one is superior?"

"What's the distinction between the two?"

"Can I use both of them?"

"How do I conduct an analysis?"

"What do I examine?"

So, let's begin at the beginning...

The Basics of the Fundamentals

Fundamental analysis is a method of evaluating an asset that attempts to measure its intrinsic value by investigating the underlying forces that may affect the asset.

Fundamental Analysis consists of the following components:

Interest rates and other government policies are examples of geopolitical factors.

Macroeconomic factors – such as unemployment rates –

Mergers and acquisitions, for example, are examples of company or industry-specific factors.

What makes it useful?

So, why is Fundamental Analysis so widely used, and what does it assist us in accomplishing and comprehending?

We can determine the overall health of an economy using fundamental analysis, which gives us a mid- to long-term outlook on market direction.

Fundamental analysis assists us in determining an asset's intrinsic value. The fundamental analysis concept is that each asset has a "correct" price, which allows us to determine whether the current market price is overvalued or undervalued. Keeping in mind that the price will always revert to what is "correct," knowing whether the asset is under or overvalued tells us whether to buy or sell.

Central Banks of the Major Industrialized Nations

The following are a few major industrialised countries, their central banks, and the chairman or governor:

The Federal Reserve [FOMC - Federal Open Market Committee] is the central bank of the United States. - Janet Yellen, Chairman

Europe is home to the European Central Bank (ECB). - Mario Draghi, Chairman

The Bank of England [BoE (MPC - Monetary Policy Committee)] is the central bank of the United Kingdom. - Mark Carney, Governor

Japan's central bank, the Bank of Japan [BoJ], - Haruhiko Kuroda, Governor

Central banks make decisions that affect the economy, and decisions that affect the economy affect your trading, so if you see any of these guys on TV, pay attention to what they say because it's likely to be something important.

Interest Rates

Every time the FOMC's chairman, Janet Yellen, gives a speech, everyone plays a guessing game to figure out what will happen with interest rates.

The interest rate is defined as;

'The cost of borrowing money expressed as a percentage of the loan amount.'

Understanding Interest rates are important when discussing factors such as the money supply or inflation because central banks use interest rate manipulation to control the money supply and combat inflation.

You may be wondering why this is relevant to you; changes in interest rates cause changes in the economy, and changes in the economy affect your trading.

As an example, consider raising interest rates.

This effectively makes borrowing money more difficult, and as a result, people spend less. Because of the decrease in spending, the demand for many goods falls, and as a result, their prices fall as well.

When the central bank fears that the economy is "inflamed," it will often raise interest rates to make borrowing more difficult in order to reduce expenditure and cool the economy down in order to avoid inflation.

As an example, consider the reduction of interest rates.

This effectively allows us to borrow money more easily, and as a result, people's spending increases. The increased spending implies an increase in the demand for many goods, and as the demand for these goods rises, so will their prices.

When the central bank believes that the economy is on the verge of a recession, interest rates will be reduced in order to encourage spending and promote economic growth.

The Money Supply

The primary function of a central bank is to manage a country's money supply.

Central banks effectively increase the money supply by lowering borrowing costs.

The total amount of bills, notes, coins, loans, credit, and other liquid instruments in circulation within a country's economy is referred to as the money supply.

Money supply is measured by M0, M1, M2, and M3, with M0 being the most specific (cash and liquid assets) and M3 being the most general.

The money supply is an important factor to monitor, especially if you plan to trade foreign exchange.

Increased money supply indicates the beginnings of inflation – if the supply of money exceeds the supply of goods, prices are likely to rise – hello, inflation.

Previously, the government would set targets for the rate of growth of the money supply and would frequently manipulate interest rates to force the supply to fall within their suggested brackets. Indeed, many argue that the over-manipulation of interest rates in the 1980s [a period when the US government believed the money supply was growing proportionately out of control] was to blame for the ensuing economic downturn.

They appear to have learned their lesson; governments no longer force monetary growth to fall within their target ranges. Governments nowadays "play it by ear," waiting for the right moment to act in order to maintain stability, keep inflation under control, and promote long-term growth.

Inflation

What exactly is inflation?

We've talked a lot about inflation in this module, and if you haven't figured it out yet, inflation is simply 'rising prices.' It can also be defined as a steady rise in the prices of goods and services.

What effect does inflation have?

Inflation causes what is known as an erosion of your money's purchasing power.

In other words, your money is worthless, you can buy less with a buck [or pound or euro], and it's all due to inflation.

What factors contribute to inflation?

Inflation is caused by two main factors:

Demand-Pull Inflation: When aggregate demand exceeds aggregate supply, this type of inflation occurs. When there is more demand than supply, prices rise, resulting in inflation.

Cost-push inflation occurs as a result of an increase in the prices of goods and services, such as wages and raw materials. These increased costs cause supply to decrease, and as a result, demand will outnumber supply. Again, when there is more demand than supply, prices rise, resulting in inflation.

What are the various types of inflation?

Hyperinflation - Inflation that is extremely rapid or out of control.

Deflation is the inverse of inflation and is defined as a drop in prices.

Stagflation is defined as slow economic growth accompanied by rising inflation.

Disinflation is defined as a slowing of the rate of inflation.

Economic Release

Every country in the world will experience what is known as an economic release at some point in time. A data release is the periodic publication of qualitative and quantitative economic data and news.

These statistics or press releases help to paint a picture of a company's or country's overall economic health. A more optimistic view of a company's or country's economy should be reflected in a higher stock price or stronger domestic currency.

This data/news can affect prices in both the short and long term, and traders will look to profit from any movement caused by these economic data releases. As a result, investors will base their investment decisions on their interpretation of the economic data that has been released.

Economic Data Highlights

The key to trading data is to compare the results of the data/news release to the expected forecast.

The greater the difference between the actual and forecast figures, the greater the likelihood of a larger price change.

The importance of the data will also play a role in determining the strength of price moves.

Here's an example of an economic data release:

Nonfarm Payrolls in the United States – [Monthly] Counts the number of new or lost jobs each month, excluding the agricultural sector.

We can see for the month of July...

The estimated figure is -65k.

The previous figure is equal to -125k.

The correct answer is -131k.

Finally, the revised figure is = -221k.

We can see that the actual figure is more than twice as large as the forecasted figure – and, as previously stated, the larger the difference, the more likely the fluctuation.

Higher-than-expected unemployment rates are bad news in this case, so the Dollar initially fell.

What exactly is Technical Analysis?

Now that we've discussed fundamental analysis and what it entails, let's take a closer look at technical analysis.

What exactly is technical analysis?

Technical analysis, as opposed to fundamental analysis, is more concerned with pattern recognition. Fundamental analysis is concerned with an asset's intrinsic value and what its price should be.

Technical analysis is a subjective art based on predicting future price movements based on past price movements. Simply put, it assists investors in predicting what will happen in the future by examining what has happened in the past.

What is the purpose of technical analysis?

It's a common misconception that all technical analysis entails is a plethora of charts. There are many skills involved in technical analysis that, when used correctly, can increase the likelihood of a winning trade by predicting the likely price action.

Pivot Points + Support & Resistance Levels

Breakout Points + Trend Lines & Channels

Patterns on a Chart

Points of Entry and Exit for Trade

Points of Strategic Loss

Technical analysis can be viewed as yet another method of risk reduction.

Support and Resistance

Support and resistance is a technical analysis concept that suggests that the market price of an asset will tend to fall and rise at predetermined levels.

Support

The support level is the point at which the price tends to find support as it falls; the price is more likely to "bounce" off this point rather than break through it. If a price does break through its support, it will frequently continue to fall until a new support level is found.

Resistance

Resistance is the inverse of support; it is the level at which the price tends to encounter resistance as it rises, and it is more likely that the price will "bounce" off this level rather than break through it.

If a price breaks through its resistance level, it will frequently continue to rise until it encounters another resistance level.

The diagram above depicts support and resistance levels.

The upward trending "zigzag" pattern we see here demonstrates how new levels of support and resistance are determined as the market moves.

When the market rises and then falls, the highest point prior to the fall is identified as the price resistance level.

Similarly, as the market rises again, the lowest point reached before the rise begins serves as the support level.

In the case of a downward trend, the opposite is true.

How do I find both support and opposition?

Now that you have a general understanding of what levels of support and resistance are, it's time to learn how to identify them.

Unfortunately, it isn't as simple as A, B, C; support and resistance levels aren't exact numbers that can be calculated using a formula or rule. A support or resistance level may appear to have broken, but we soon discover that the market was only testing it and that the support and resistance levels remain in place.

Because support and resistance levels are frequently depicted as lines when they are not, in fact, exact figures, it is sometimes easier to think of support and resistance as zones rather than definitive levels.

The two types of support and opposition

There are two kinds of support and resistance: major and minor.

A price can move up, for example, by breaking the minor resistance in order to test the major resistance, and as shown below, a price move against the trend is frequently halted by the minor resistance or support and reversed.

The stronger the support and resistance zones appear to be, the more frequently a price tests the levels of support and resistance without actually breaking through them.

Trendlines and Channels

Trendlines

"The trend is your friend," as the saying goes, and the theory behind it is simple: it is perceived as easy to make money trading in the same direction as the trend.

An uptrend line (consecutive higher highs and lower lows) is shown as a line drawn along the bottom of easily identifiable support areas.

The trend line in a downtrend (consecutive lower highs and lower lows) is drawn along the top of easily identifiable resistance areas.

Channels

Channels can be thought of as adding another dimension to the trend line theory that we discussed earlier.

A channel is simply formed by drawing a parallel line at the same angle as the uptrend or downtrend.

Draw a parallel line at the same angle as an uptrend line and then move it to the position where it touches the most recent high to create an uptrend channel.

Draw a parallel line at the same angle as the downtrend line and then move it to a position where it touches the most recent low to create a downtrend channel.

[This should be done at the same time as the trend line]

When prices reach the bottom trend line, this could be a good time to buy.

When prices reach the upper trend line, this could be a good time to sell.

Indicators

Technical indicators are divided into two categories: leading and lagging indicators.

Leading indicators will change ahead of expected economic trends; they are frequently used to forecast future movements but are not always accurate.

Lagging indicators are used to summarise past movements rather than predict future movements; they change after the economy has already begun to follow a specific pattern or trend.

Lagging Indicators

Moving Averages

A moving average is a type of technical indicator used by traders to calculate the average price of a security over a given period of time.

Moving averages are classified into two types: simple moving averages [SMA] and exponential moving averages [EMA].

Simple Moving Averages (SMAs) (SMA)

A simple moving average is calculated by adding the closing prices from the previous "X" period and then dividing that total by X.

If you plotted a 10-period simple moving average on a 1-hour chart, you would add the closing prices for the previous 10 hours and divide the total by 10. That is a simple moving average.

A simple moving average reflects the market's overall sentiment at a given point in time. It can be used to identify support and resistance as well as generate buy/sell signals, and it helps to show market direction by smoothing out market noise (price fluctuations) over time.

We can see that the longer the SMA period, the further it lags behind the current price; that is, the higher the number period you use, the slower it is to react to a current price movement.

One issue that traders frequently encounter with SMAs is that they are extremely susceptible to price spikes.

Exponential Moving Averages (EMAs)

EMAs give more weight to recent periods and respond to recent prices faster than SMAs. The shorter the EMA period, the more weight the current price will have in the MA curve – and vice versa.

SMAs vs. EMAs

Now that you understand the distinction between simple and exponential moving averages, you're probably wondering when you'd use them and, more importantly, which one is superior.

The answer is either; it may sound cliché, but it really depends on your trading style, as with most methods of analysis.

Let's go over the benefits and drawbacks of both SMAs and EMAs to help you decide which is best for your trading strategy.

EMAs respond to price movements faster and more accurately than simple moving averages, allowing you to catch recent trends sooner and more accurately.

BUT

Because EMAs react so quickly to price movements, a price spike is frequently misinterpreted as the start of a trend.

When looking at the market's long-term and overall movement, SMAs are preferable. It is best suited for longer-term trends and avoids the price spikes that can occur when using EMAs. However, while SMAs are beneficial in the long run, the slow reaction time causes a price lag, making short-term movements more difficult to capitalise on.

Now that we've compared the two, it's up to you to decide which one you want to use. Consider whether you want to predict a long-term trend or profit from a short-term movement.

If you're not sure which to use, there's no harm in using both; the EMA to get a general idea of the overall trend, and the SMA to capitalise on short-term movements.

Moving averages: How to Use Them

Moving averages are used in a variety of trading strategies, including:

Recognizing trends and reversals

Measuring the momentum of the market

Recognizing levels of support and opposition

Identifying possible entry and exit points

Recognizing Trends

Moving averages, as previously stated, are lagging indicators; they do not predict new trends, but rather confirm those that have already begun.

Moving averages are frequently used to identify trends, as shown in the graph above. When the price of the product exceeds the moving average, the price is said to be in an uptrend. Many traders, for example, will only consider going long if the price is trading above a moving average.

The inverse is also true; when there is a downward slope with prices lower than the moving average, traders will use this to confirm a downtrend.

Using Moving Averages to Determine Momentum

Moving averages can also be used to assess the strength and direction of a market's momentum.

Three moving averages have been applied to the graph below;

[short term] Blue EMA50

EMA100 in pink [medium term]

[Long-term] Orange - EMA200

The three moving averages used here have different time frames to represent short-term, medium-term, and long-term price movements, respectively.

In this graph, there is an upward trend when the shorter-term averages are above the longer-term averages.

When the shorter-term averages are lower than the longer-term averages, the momentum is downward.

Using Moving Averages to Find Support and Resistance

A market's falling price can come to a halt and reverse direction at the same level as an important average. As a result, moving averages are frequently used to identify support and resistance levels on a chart.

The graph below shows an example of how the 200-day moving average can be used to provide support.

Moving averages based on longer time periods will provide a more robust and consistent picture of a support level than shorter time frames.

When the price falls below an important moving average, it can act as a resistance level, which traders frequently use as a signal to take profits or close out any existing long positions.

Traders also use these averages as entry points for short positions because the price frequently bounces off the resistance and continues to fall.

Using Moving Averages to Find Crossovers

Moving averages can be used to generate buy and sell signals by detecting the beginning of an uptrend or downtrend.

Moving averages, as previously discussed, can be used to define up and down trends. As a result, moving averages can be used as a buy or sell signal.

A cross above a moving average can be interpreted as an indication to go long or close out a short position.

A cross below a moving average can be interpreted as an indication to go short or close out a long position.

The most common type of crossover occurs when the price moves from one side of a moving average to the other, as shown in the graph below.

[short term] Blue EMA20

Pink EMA100 (Long Term)

When a short-term average crosses through a long-term average, it can indicate that momentum is shifting in one direction and that a big move is on the way.

When the short-term average crosses above the long-term average, it is a buy signal.

When a short-term average crosses below a long-term average, this is a sell signal.

Leading Indicators

As mentioned before leading indicators will change in advance of expected economic trends; they are often used to predict future movements but not always necessarily accurate.

Now that we have discussed moving averages, an example of a lagging indicator, let us move on to the Relative Strength Index which is a type of leading indicator.

Relative Strength Index (RSI)

The Relative Strength Index [RSI] determines the speed and change of price movements; it allows traders to measure the buying or selling momentum of a product. RSI oscillates between 0 and 100 and generally, a market is thought to be overbought once the RSI approaches 70. This is a good indication that the asset may be getting overvalued and is a good candidate for a pullback.

Conversely, in instances where the RSI approaches 30, it is an indication the market may be oversold and therefore the asset is likely to become undervalued.

What does Overbought mean?

In technical analysis, overbought is a situation in which the price of a market has risen to such a degree - usually on high volume - that an oscillator, for example, an RSI, has reached its upper bound.

Put more simply it is when the demand for a product pushes the price of a market up to unjustifiable levels.

Generally, when a product is overbought it is an indication that the market is becoming overvalued and may experience a pullback.

What does Oversold mean?

Oversold is simply the opposite to overbought.

Oversold is a condition in which the price of a market has declined too steeply and too fast in relation to underlying fundamental factors. This condition is usually a result of market overreaction or panic selling.

Overselling is generally interpreted as a sign that the price of the asset is becoming undervalued and may represent a buying opportunity for investors.

Hopefully, it is now more clear to you what it means to say an asset is overbought or oversold, but please remember that determining the degree in which an asset is overbought or oversold is very subjective and can differ between traders.

Stochastic Oscillator

Stochastic Oscillator is another example of a leading indicator; it is a momentum indicator that measures the speed of change of price or the impulse of the price. It does this by comparing an asset's closing price against its price range over a given time period.

Similar to RSI Stochastic Oscillators also have levels that indicate potential trends or points of entry or exit

Traders will often look to sell when the Stochastic Oscillator line rises above 80m predicting that it will inevitably then fall back below. Traders will also look to buy when the level falls below 20 predicting that it will increase above this level.

Another way of utilizing stochastic oscillators is to watch timing trades. The graph below gives an example of this;

%K = Black

%D = Red

$\%K = (\text{Current Close} - \text{Lowest Low}) / (\text{Highest High} - \text{Lowest Low}) * 100$

%D = 3-day SMA of %K

The %K is called the faster moving of the two lines and compares the latest closing price to the recent trading range. %D is a signal line calculated by smoothing out %K; It is a 3-day simple moving average of %K which is plotted alongside %K to act as a signal or trigger line.

Traders will look to sell when the %K (Fast) line shifts below the %D (Slow) line and will look to buy when the %K line shifts over the %D line.

The theory behind this indicator is that in an upward-trending market, prices tend to close near their high, and during a downward-trending market, prices tend to close near their low. Transaction signals occur when the %K crosses through a three-period moving average called the "%D".

The sensitivity of the oscillator can be adjusted by changing the time period for the %D or %K lines.

Bollinger Bands

Bollinger band is an analytical tool used by traders to identify a market's volatility and looks at the levels of current prices relative to previous trades.

We can see from the above graph that in an instance where there is little volatility the band's contract and as the market becomes increasingly volatile the bands expand.

It may be simpler to look at Bollinger bands as a form of support and resistance.

Often what is seen with Bollinger bands is that as the price deviates from the band it often tends to return back to a middle ground; this is what is known as the Bollinger Bounce.

Often the bands can be seen to "squeeze" together with such as in the graph below:

Many traders see a band squeeze as an indication that there is a pending breakout in the market. If the graph is seen to move towards the upper band then an upwards trend is usually expected. The opposite is true when the candlestick is seen to be approaching the lower bound.

An example of a "breakout can be seen below":

It is not an often occurrence to see a Bollinger squeeze; when looking at a 15-minute candlestick chart it will be experienced only a couple of times a week.

Fibonacci Sequence

Fibonacci sequence is used widely in many different industries in the world which is why it may sound the most familiar to you out of all the technical analysis tools we have covered so far.

Leonard Fibonacci was an Italian mathematician (1200 AD) who discovered a simple sequence of numbers (Fibonacci numbers) that are used today in what is called Fibonacci retracement as a popular technical analysis tool.

Fibonacci Numbers are as follows; 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55 and so on.

More important than the sequence itself is the mathematical relationship between the numbers. It is the quotient of any two adjacent numbers in the sequence that is what's important to us; each term in this sequence is the sum of the two preceding terms.

Fibonacci retracement works by taking two extreme points on a chart and dividing the vertical distance between the two points by what is known as the Fibonacci ratios. These ratios are 23.6%, 38.2%, 50%, 61.8% and 100% and the quotient of adjacent numbers in the sequence. Once these calculations have been done and the point defined they are noted on the graph using horizontal lines. These lines are interpreted by many traders as levels of support and resistance and are also used to help identify strategic places for transactions to be placed, and target prices or stop losses to be selected.

Chart Patterns

Technical analysis, like we said before, is not just about charts. It does, however, rely heavily on them and often uses chart patterns to assist in making trading decisions.

The underlying theory is that traders often expect chart patterns to repeat, and this prediction is what presents them with various trading opportunities.

The most common chart patterns are:

- Symmetrical Triangles
- Ascending Triangles
- Descending Triangles
- Double Top
- Double Bottom
- Head and Shoulders
- Reverse Head and Shoulders

Chart patterns - Triangles

Triangles represent continuation patterns and there are three main types;

Symmetrical Triangles - Neutral pattern signaling breakout to either side, though usually a continuation pattern

So how do you spot a systematic triangle pattern?

Symmetrical triangles have distinct pattern signs and these can be seen in the image below

- Upper trend line downwards sloping
- Lower trend line upward sloping
- Both trend lines converging together
- Breakout to upside or downside being confirmation of trend in that direction

The slope of the price's highs and the slope of the price's lows converge together to a point where it looks like a triangle.

In the below example of a systematic triangle, the market is making lower highs and higher lows. This type of price activity is called consolidation.

Traders who use symmetrical triangles are often looking for a breakout; i.e. when the pattern reaches a stage where the price moves decisively in one direction or the other. Much like we explained in the Bollinger "squeeze" a breakout often occurs after a consolidation as seen below; traders wait for the price to either move above the top trend line or below the bottom trend line.

Ascending Triangles - Bullish continuation pattern

Ascending triangles also have pattern traits with which you can identify it.

- Upper trend line horizontal/flat
- Lower trend line upward sloping
- Both trend lines converging together
- Breakout to the upside through upper resistance

Ascending triangles are experienced in instances where there is a resistance level coupled with a slope of higher lows as seen below;

Again traders will often wait to see if the price finally breaks the resistance level, at which point the price could breakout decisively to the upside as seen below

The alternative occurs when the resistance level proves too strong for an upward break through and the price move reverses downwards.

Descending Triangles – Bearish continuation pattern

Finally, there are descending triangles; Descending triangles are essentially the opposite of ascending triangles.

- Upper trend line downwards sloping
- Lower trend line horizontal/flat
- Both trend lines converging together
- Breakout to the downside through lower support

Above we can see a descending series of highs, which forms the upper line. The lower line is a support level in which the price cannot seem to move below.

Unlike with ascending triangles where traders are waiting for an uptrend breakthrough traders witnessing a descending triangle are expecting a bearish market and are waiting to see if the price eventually makes a breakout to the downside through the support level.

The alternative scenario will occur when the support level proves too strong for a downward break; the price will then be seen to “bounce” off of the support level and generally begin in an upward movement.

Double Tops – Reversal Pattern

A double top is a **bearish reversal pattern** that is formed after there is an extended move up.

The “tops”, as seen above, are peaks which are formed when the price hits a resistance level that appears it is unable to break.

We can see in the diagram above that having bounced off the support level slightly the price then returns to re-test the support again. If the price is unable to break through the support level for the second time and is seen to bounce off of that level again, a DOUBLE top chart pattern has been formed.

Referring back to the diagram above again we can see that the 2nd “top” was unable to break the high of the 1st. Traders often interpret this as a strong sign that a reversal is going to occur as this movement implies that the buying pressure is lessening.

When using double tops as a form of analysis traders will often look to go short below the level which is referred to as the “neckline”. When the price level falls below the neckline traders will expect the reversal of an upward trend.

Double Bottom – Reversal Pattern

A double bottom is the opposite of a double top. It is a **bullish trend reversal** formation, meaning that unlike with double tops traders are now looking for the price to reverse upwards after it has been coming down.

Head and Shoulders

Head and shoulders is another form of a reversal pattern which has two main types;

- Head and shoulders – Pattern formation that indicates a reversal in an uptrend [bearish]
- Inverse Head and Shoulders – Pattern formation signaling a reverse in a downtrend [bullish]

Head and Shoulders

Head and Shoulders are formed by a peak, known as the “shoulder” which is then followed by another higher peak, the “head”. Following on from this high peak [head] another shoulder is seen depicting a lower peak.

Finally, we can see that there is a neckline which is drawn by connecting the lowest points of the two troughs. Although in this case, the neckline is a straight line it can be either upwards or downwards slope.

Much the same as the double bottom and top formations traders using head and shoulders will also look to sell once the price falls just below the neckline as it is thought to imply an impending downward trend.

Reverse Head and Shoulders

A reverse head and shoulders are pretty self-explanatory; it's a head and shoulders formation, in reverse.

An inverse head and shoulders formation is a bullish reversal pattern and so traders will look to buy when the price increases above the neckline as they will be expecting an upward trend breakthrough.

Japanese Candlestick Formations

Basic candlestick patterns - Spinning Tops

A spinning top is one of the most commonly seen candlestick patterns. This type of pattern is often regarded as neutral and indicates indecision between buyers and sellers and the future movements of an asset.

We can see above that the body of the spinning top is small despite there possibly being a large amount of price fluctuation during the day. It is also either green or red in color, indicating an upward or downward sentiment.

Traders use the presence of a spinning top to predict whether there is an impending up or downward trend. For example, if after a long uptrend a spinning top form this generally means that buyers have begun to lose interest and it is indicative of an impending downtrend. The opposite is also true.

Basic candlestick patterns – Marubozu

Marubozu pattern at first glance looks very similar to the spinning top candlestick formation described above.

The main differences between the two are that the marubozu are larger in size and unlike spinning tops do not have shadows. Again the two colors, green and red, indicate whether the market is bullish or bearish.

We can see for example in a bullish market that the open price = low price and that the high price = close price. The green marubozu pattern is often seen as the first part of a bullish continuation or a bullish reversal pattern and so many traders will buy into a market in which they see a bullish marubozu.

The opposite here is the bearish marubozu which is seen in red. In this case, the low price = close price and open price = high price. A bearish marubozu implies an impending bearish reversal or a bearish continuation and so many traders use the red marubozu as an indication to sell into the market.

Basic candlestick patterns – Doji

Doji candlesticks are said to be “neutral” as they do not indicate a definitive upward or downward trend and so indicate indecision amongst traders.

Doji candlesticks are in a way similar to spinning top candlesticks in that they have very small bodies, in the case of Doji the body is simply a bar as seen below. Also similar to spinning tops, Doji candlestick patterns can be seen to display long shadows.

There are four main types of Doji candlesticks;

First, let us look at the long-legged Doji – here we can see that opening and closing prices were essentially equal. This long-legged Doji implies that there is almost equilibrium between supply and demand and that there may be a turning point in the direction of the prices approaching.

Next, there is the dragonfly Doji – similar to the long-legged Doji the dragonfly Doji also forms when an assets opening and closing prices are equal. The long bottom shadow, however, means that this equilibrium took place at the high of the day. Again it implies that the direction of the trend is nearing a major breakthrough with the longer lower shadow implying the possible reversal of a bearish trend.

A gravestone Doji is essentially the opposite of the dragonfly Doji explained above. It forms when the opening and closing prices are equal and occur at the end of the day. The long upper shadow implies that the days buying pressure was countered by sellers and that a bullish uptrend is about to be reversed.

Finally, a four price Doji is a candlestick formation where the day's high, low, open and close price were all equal. This is the most neutral of all the Doji candlestick formations and does not occur often. It is seen mostly in times where there is a very low volume of trading such as after hours and is often disregarded by traders as being a result of bad data.

Although Doji Candlesticks are important, it is their combination with preceding patterns which traders look most at. For example, if a Doji candlestick appears after a series of candlesticks with long green bodies it is an indication that buying pressure is weakening. Conversely, if a Doji candlestick is seen after a series of red candlesticks this is an indication that selling pressure is weakened.

Basic candlestick patterns – Hammer and Hanging man

The hammer and hanging man look very similar with short bodies and long lower tails, but they have very different indications.

The hammer, which can be seen above on the left in green, is a bullish reversal pattern that forms during a downtrend. When prices are falling hammers signal that the support level has been approached and prices may well begin to rise again. Traders often take a hammerman as an indication of an impending price rise, but it is always safer to wait a while and confirm a bullish trend before buying.

The hanging man, which can be seen above in red, is the opposite of the hammer man. It is a bearish reversal pattern that often is seen to mark a top or strong resistance. When price rises the formation of a hanging man is often taken by traders as an indication that selling pressure is larger than upward buying pressure.

Basic Candlestick Patterns: Inverted Hammer & Shooting Star

The inverted hammer occurs when a falling price indicates the possibility of a reversal. Its long upper shadow as seen below showing us that buyers are attempting to counter the downward pressure and were able to close the session near its open as opposed allowing the price to be pushed down further.

The shooting star is a bearish reversal pattern that looks identical to the inverted hammer but occurs when prices have been rising.

Its shape indicates that the price opened at its low, rallied, but pulled back to the bottom. Conversely, to the inverted hammer, the shooting star shows us that sellers countered the upward pressure of buyers and were able to keep the day's close almost equal to its open and avoid any further upward pressure.

Conclusion

We're finally done analyzing; and now that you know the basics of both technical and fundamental analysis it's up to you to put your newly learned skills to use. It depends on your trading style, your objectives, your time frame and many other factors. Don't put yourself in a box and stick to one style, there's value in diversity. You can use any or all of these different methods as each complements the other. Many investors use technical analysis and graphing to decide on strategic exit and entry points, but use fundamental analysis to decide which asset to trade on. There are limitless combinations, and limitless opportunity – good luck with your trading!

5. Risk

Financial Risk

The risk in any situation is **Uncertainty**

'The chance of an outcome being different than expected'

So now that we know what risk is, what exactly is the risk in terms of finance?

'The chance of an investment's actual return being different than expected' It's often said that trading the financial markets is effectively the trading of risk.

Example: "By buying EUR/USD, I effectively have the opinion the Euro will strengthen against the US Dollar"

The risk is the possibility of the Euro weakening against the US Dollar – an adverse movement

In other words, financial risk is the possibility of losing part or all of your original investment

Why "Risk" It

If trading the financial markets is effectively the trading of risk, then why would we "risk" the market goes against us?

Although risk makes us susceptible to adverse movements in the market, risk also presents the potential/opportunity to make huge amounts of money.

Risk = opportunity And The higher the risk, the higher the potential opportunity

The Risk/Reward Trade-Off

The higher the risk an investor takes on, the higher the potential returns should be in order to compensate the increased risk. This is known as The Risk/Reward Trade-Off

Low Risk = Low Return

High Risk = High Return

What Makes Trading such risky business

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Risk Management Tools

Stop Loss Orders

Stop Loss Orders are the single most important risk management tool and should always be employed when trading

Types of Stops

Breakeven Stops – executed at the point at which gains equal losses

Time Stops – it relies on a certain period of time elapsing before the order is executed

Trailing stops - set at a percentage level below the market price. It allows you to let profits run on and minimise your losses at the same time.

Learn to love your losses, manage your losses, and learn from your losses, or one day you will have the mother of all losses that will wipe out your entire account

Risk Tolerance

Low-risk investments will have lower return potential than high-risk investments.

Low Risk = Potential Low Return

Medium Risk = Potential Medium Return

High Risk = Potential High Return

Your trading style will often define how low or high risk your strategy is but even the greatest investment/trading strategies are of little help if you do not control risk

How tough are you?

Your Risk Tolerance is the degree of uncertainty you can handle regarding a potential loss or decrease in your investment portfolio value

Risk tolerance will be different for each person and how much you can handle generally depends on three things;

- **Income** - Your personal income and personal situation e.g. A person on a low salary about to get married will be likely to have a low to moderate risk appetite and will, therefore, most probably have lower risk capital available than a single person on a median salary
- **Time Horizon** - The amount of time you plan to keep your money invested. Longer time horizons are associated with less risk than shorter time horizons
- **Investment Objectives** - The greater your financial goals, the greater the risk you will likely have to take on

Mitigating the Risk

What is asset allocation?

Asset allocation is an investment strategy aimed to balance risk and reward. It shares out the portfolio's assets according to your investment goals, risk tolerance and time horizon.

Different asset allocations have different levels of risk, below is an example of the risk associated with a selection of asset allocations;

Diversification

'A risk management technique that aims to reduce risk through mixing up your portfolio with many different investments'

Diversification is particularly helpful when trying to offset unsystematic risk, which is industry/company specific.

Diversification is based on the rationale that any bad performers should be offset by good performers thus smoothing out unsystematic risk.

The lower the correlation between investments in your portfolio, the lower the risk

Example of Correlation;

Gold and the US Dollar

Gold is inversely correlated to the dollar means that the value of gold appreciates as the dollar weakens

Gold and Crude Oil

Rising crude oil prices tend to lead to a rise in the value of gold as gold is often bought as a hedge against inflation

Controlling Your Leverage

Leverage Scale: - - - **Risk Level**

Remember! Leverage can be tailored according to your risk appetite. If you are risk-averse, trade on higher margin requirements to reduce your leverage

Be Careful! Learn to control your leverage, treat it as a credit card, be careful not to get carried away with money you don't have just because it's available!

Technical Analysis

The technical analysis serves as an important aid in risk management

We can use it to:

- Identify & Time Entry/Exit points
- Identify Support & Resistance
- Strategic Stop Loss Orders
- Identify Trends & Chart Patterns
- Create Risk Parameters - Technical Indicators

All the above will aid the reduction of risk and help improve your chances of making profits.

For more information on Technical Analysis please see the "Analysis" Module

Golden Rules for Trading in a Volatile Market

1. Use Stop Losses

Using a stop loss – a present level at which an open trade is automatically closed – is standard good practice as this can limit your downside risk and also shows trading discipline which is paramount in developing a healthy trading account. However, when markets are incredibly volatile you could experience some slippage with the position not being able to be executed at the exact level specified. In volatile markets, there is often a “gap”, where a product moves substantially lower or higher than expected perhaps as much as 10-15%. With a normal stop loss, you will get the first available price which could cause a large loss and result in a loss greater than your initial deposit.

2. Reduce Your Trade Size

Margin is one of the biggest advantages of CFD trading and at Accuindex Markets our 0.25% on FX, 0.50% on spot gold and major Indices and 3% on commodities are among the most competitive in the marketplace however with any margin trading you should always be aware of how much is required to keep your position in the market. A general rule of thumb is that no single trading position should amount to risk exposure of more than 5% of your available capital. However, in volatile market conditions, this kind of leverage is dangerous as any losses will magnify by even more than normal. The best market practice would be to halve your normal trading size over volatile trading conditions.

3: Limit Your Trades

Volatile markets are associated with high volumes of trading, which may cause delays in execution. While online trading normally means you place a trade at a current bid and offer you see, some market maker may widen bid-offer spreads or even temporarily withdraw tradable prices. This means that execution can be delayed and prices to execute it may not be available. Accuindex provides fixed spreads no matter what market conditions but in times of increased volatility it is sometimes better to limit trade execution.

4: Stick to Your Strategy

During volatile times, it is easy to be shaken and diverted from your normal trading strategy but most experienced traders apply the same strategy to choosing investments as they normally do. While it's tempting to react to the volatility, it's incredibly difficult to predict moves in the short term, so you have to stick to your trading strategies and limit your risk exposure when times are volatile.

What are the important bits?

- We need Risk Management to control our losses
- Always be sure to know your Risk Tolerance
- Have a Risk Management strategy - Leverage/Volatility/Diversification/Asset Allocation
- Incorporate a Stop Loss strategy as part of your Risk management strategy
- Be disciplined in affecting your strategy

PLAN YOUR WORK AND WORK YOUR PLAN

6. Trading Psychology

The Emotions of Trading

When trading there are two emotions that are more common, and more dangerous, than all the rest; **fear** and **greed**.

Fear and greed can ruin even the best trading strategies

One moment of fear or greed can lead to a moment of madness and months of hard-won profits going down the drain

Uncontrolled emotions should not be an excuse for losses and losses should not be an excuse for uncontrolled emotions

Remember!! Trading affects psychology as much as psychology affects trading

Greed

“You can’t feed on greed”

- Many people think that greed is thinking that the sole aim of trading is to make money.
- This is NOT what greed is

Greed is trying to make money too quickly

There are lots of ways to be greedy in trading;

- Trading in sizes that are too large
- Trading too frequently
- Having unrealistic expectations
- Dreaming of the big hit trade, rather than steadily building your equity

Fear

Fear in trading has two faces;

- Fear of loss
- Fear of missing out

The fear of loss compels traders to close profitable trades prematurely, meaning they miss out on potential profit

The fear of missing out compels traders to abandon their trading strategy so they do not miss a major price move

Fear is NOT good as it leads to overtrading and miss-timed entry and exit points

So

DON'T BE SCARED!!

Managing Risk and Emotion

Risk management involves calculating how much risk you are prepared to tolerate in order to make a profit

For a more detailed look at Risk and Risk Management tools please refer back to the "Risk" Module

When trading it is important that traders realize the importance of Risk Management; it teaches you to pace yourself, to think clearly, and most of all, it helps keep your emotions under control.

Here are a few things you should think about when trading

Trade size - Start with small trades

When you take a hot bath, you don't just jump in straight away; you test the water temperature with your toes first. Trading is no different. Never jump into the market with your entire position. Test the market first with a smaller trade before taking your full position

- Trade sizes that are too large for your account can cause exaggerated price swings and play havoc with your account as well as your emotions. This can then lead to mistakes caused by fear or greed. Like we said before trading affects psychology as much as psychology affects trading
- Do not forget that a trade can go wrong – if you are dreaming of a huge profit by taking a large trade size, remember this high-risk trade can also produce a loss as big as the profit you were dreaming of.

Risk/reward ratio

Aim for at least a 3-1 or at worst a 2-1 Profit/Loss ratio

- For example, if you are aiming for 60 pips profit, your maximum loss should be around 30 pips. Or, if the maximum loss you are prepared to take is \$1000, your profit target should be at least \$2000
- If your trading style is to get in and out of the market for a small profit each time then make sure your losses are also small.

Planning your risk/reward ratio means that you can prepare yourself mentally for the loss that you might face and prevent emotional trades.

One wrong emotional trade can produce a large enough loss to wipe out the profit of many profitable trades

P/L targets

- You should have exit points in mind before you make a trade
- You should daily have P/L targets

Once you reach this target you should stop trading so as to avoid giving profits back to the market

P/L targets help to avoid fear and greed compelling you to overtrade and/or increase your trade size

Market volatility

Sometimes of the day are more volatile than others:

Afternoon in London, which corresponds to morning in New York, is the most volatile time of day for most markets, with the largest price swings and profit potential and losses.

During periods of extreme volatility, it is usually best to stand aside if you are not an experienced trader.

Trading Tips

Here are some more trading tips that you may find useful

Implement risk management

Use stop losses and limits – these take the emotion out of closing a trade and reduce the risk of unnecessary losses as a result of attachment to a position.

Traders allow losses to grow as their emotional attachment makes them hope the price will reverse

- The hardest thing a trader has to do is manually close a losing trade; placing a stop loss order at the same time you make a trade will avoid having to do this.
- Traders often complain when their stops hit then the price reverses; never cancel a stop loss order after you have placed it. You placed the stop when you were calm before you entered the trade; now you are stressed because the trade is moving against you

Trust your original judgment!

Treat trading as a business, not a hobby

You wouldn't invest \$10,000 in a business enterprise on impulse – so don't do it when trading!

Make sure to make time for researching the markets when you are not trading

An informed trade is always a better option than an impulsive trade

Patience

Patience is a virtue in trading; it is different to not trade through fear

Patience means...

-

- ...waiting for the price to hit your indicators before trading
- ...waiting hours if necessary for the correct time to enter the market. Trading profitably is what matters, not the number of trades per day
- ...not jumping in and trading just because you see the price moving or you are bored
- ...not trading on a tip. You will find wildly divergent opinions even among so-called experts. Do your own research before you trade

Standing aside is a valid trading decision

Overtrading

- Overtrading is a common mistake made by new traders as they try and catch every small price move
- The price moves down so they sell, it moves up so they buy, in doing so they are always chasing the market and usually losing.

Learn to anticipate price moves, not just follow them

Timeframes

- Short-term trading is highly intensive and requires lots of discipline and concentration so make sure you are ready for this level of intensity and can trade without distractions
- Longer term trades do not have to be monitored constantly and are more appropriate for traders with other commitments

Coping with losing trades

Learn to love your losses

This is a term heard often in the trading world, and if you don't learn to embrace your losses, your trading career will probably be short-lived.

So, what exactly does "learn to love your losses" mean?

It means you should understand why you made a losing trade;

- Did you misread your indicators?
- Did you fail to anticipate the release of an important piece of economic data?

Some losing trades are not your fault; for example, an unpredictable event such as a terrorist attack could move the market, but...

The majority of losing trades is because the trader made an impulsive decision

- To lessen the psychological impact of a loss, redefine a loss from being a failure to being an opportunity to learn
- Do not blame the markets for your losses, the markets don't owe you anything - look at your strategy and adjust accordingly

Trade based on what the market is doing rather than what you think it should be doing. Trends and market conditions can change; make sure your strategy changes with it.

Taking profit

Cut your losers and run your winners

- Don't take profits too early through fear. Fear causes the mind to question and react while the trade is still "safe" and in profit, no matter how small.
- Conversely, don't let a winning trade turn into a loser
- Set yourself rules to follow; close a trade if the market retraces 20% from your profit target. This allows you to make sure that your emotions don't get out of hand when trading
- Except in special circumstances, get in the habit of taking your profit "too soon"
- Don't torment yourself if a trade continues not to move in your favor. A common mistake is to close a position that is in profit and keep one that shows a loss.

Building your account equity

Don't try to make your fortune in a single trade – you will never be satisfied if you have unrealistic expectations

- Aim to build your account steadily
5% per day is a great return
- Remember you will have periods of equity drawdowns or sideways movement
If you have 3 losing days in a row, take a step back from trading for at least a day to collect yourself. Use this time to reassess your strategy and analyze the market

To summarise, don't underestimate the power of your emotions...

TAKE CONTROL OF YOUR TRADING, DON'T LET TRADING TAKE CONTROL OF YOU