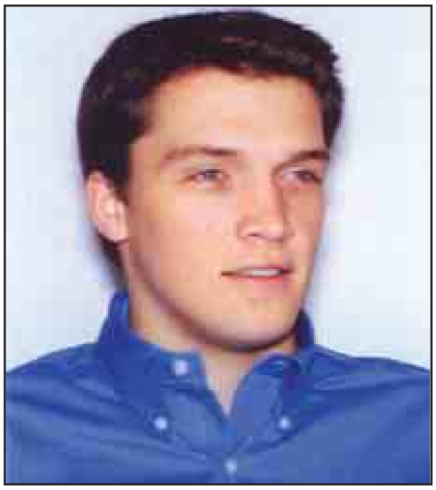
Traders Workshop

Harnessing e-tools in Trend Analysis



by Patrick Kinsel, Head Analyst, FX Trading

The ability to recognize a trend is one of the most important skills any trader can harness. The FX market, like other financial markets, will trend upwards, downwards, or sideways over varied timeframes. If a trader can learn to discern which direction the market is trending, they position themselves to succeed greatly. Today, as a result of increasingly sophisticated charting packages and trading platforms, even novice traders are easily able to utilize sophisticated indicators to help recognize trends.

A trend is simply the overall direction of the market. At some points, trends may be easily recognizable. At other times, trends may be overshadowed by wild market fluctuations or hidden within a ranging currency pair. Failing to recognize a trending market can mean death to even the most skillful trader. For example, if a trader shorts a currency pair at what they perceive to be a strong resistance point, but fails to recognize the market's overall upward trend, they may be on the wrong side of the position. Although the resistance seemed strong in this case, the upward trend is often more powerful and more likely to lead the market's movement.

As trading platforms become more sophisticated, the average trader is able to harness increasingly complicated indicators to recognize trends. Tools that were once reserved for only the most sophisticated traders are now available to anyone with a basic charting package and an internet connection.

ADX

An ADX line illustrates the directional change and/or movement on a scale of 0-100. When the ADX value is rising, the market is trending. When the ADX line falls, a trend is not presently occurring. Analyzing the ADX is only the first step; it does not tell you what direction the market is trending.

DMI

After a trader analyzes the ADX line on their chart and determines that the currency pair in question is trending, they must determine in what direction it is moving. DMI (Directional Movement Index) is a highly sophisticated mathematical function for recognizing the direction a market is trending. Prior to modern charting packages, DMI was too complex for most traders to implement. Newly developed charting software simplifies DMI by creating two lines. The first line measures +DI (positive directional movement). The second line measures -DI (negative directional movement). These values are calculated on a scale from 0-100. When the +DI crosses above the –DI line, a buy signal is created. A sell signal occurs when the +DI

crosses below the –DI line. As a result of combining the ADX and DMI indicators, the trader has discovered that the market is in fact trending and has a sense of what direction it is moving.

Moving Average

Moving averages are one of the most rudimentary indicators in use today. Moving Averages are simply the average price at a specific point in time. When these points are combined, they create a smooth line representing the market's overall movement and illustrate trends. By setting moving averages over different timeframes, a trader can ascertain a wide sense of the market's movement. Although Moving Averages were always rudimentary to calculate, modern charting packages save traders the time and effort needed to average a market's points.

Bollinger Bands

Once a trader analyzes Moving Averages, they still need to determine if the market has reached the peak of its trend or if it will continue on its present course. Although a moving average line will tell you that the market is currently trending upward or downward, it will not reveal how near it is to reversing direction.

When a trader initiates the Bollinger Bands on their platform, two lines are drawn two standard deviations away from a simple moving average line. One band lies above the moving average and one band lies below the moving average. The market's volatility is represented by the values of the standard deviations. As the market becomes more volatile, the standard deviations increase and the bands widen further from the standard moving average. As the market becomes less volatile, these same bands contract toward the standard moving average.Traders interpret Bollinger Bands in many ways. Contracting bands, symbolizing a decrease in volatility, are often interpreted to precede a sharp increase in volatility. However, most traders emphasize the market's movement within these bands. As prices near the upper band, it is an indication that the market is overbought and nearing a reversal. As prices approach the lower band, it is an indication that the market is oversold and nearing a reversal.

Although Bollinger Bands can provide an excellent sense of the market's movement, it is important to remember that they may only represent a small

fluctuation within a greater trend. To determine if the overall trend is reversing or if it is only a minor reversal before the market continues on its present course, a trader should consider all these indicators over various timeframes.

Parabolic Indicators

The ultimate purpose of these indicators is to determine entry and exit points to the market. By analyzing the ADX, DMI, and Moving Average, a trader is able to determine if the market is presently rising or falling. However, that is simply not enough information for a trader to succeed. No trader wants to buy the GBP/USD at its peak. Even though a trader may know the GBP/USD is presently trending upward, they need to determine if it will continue to rise or if and when it will reverse.

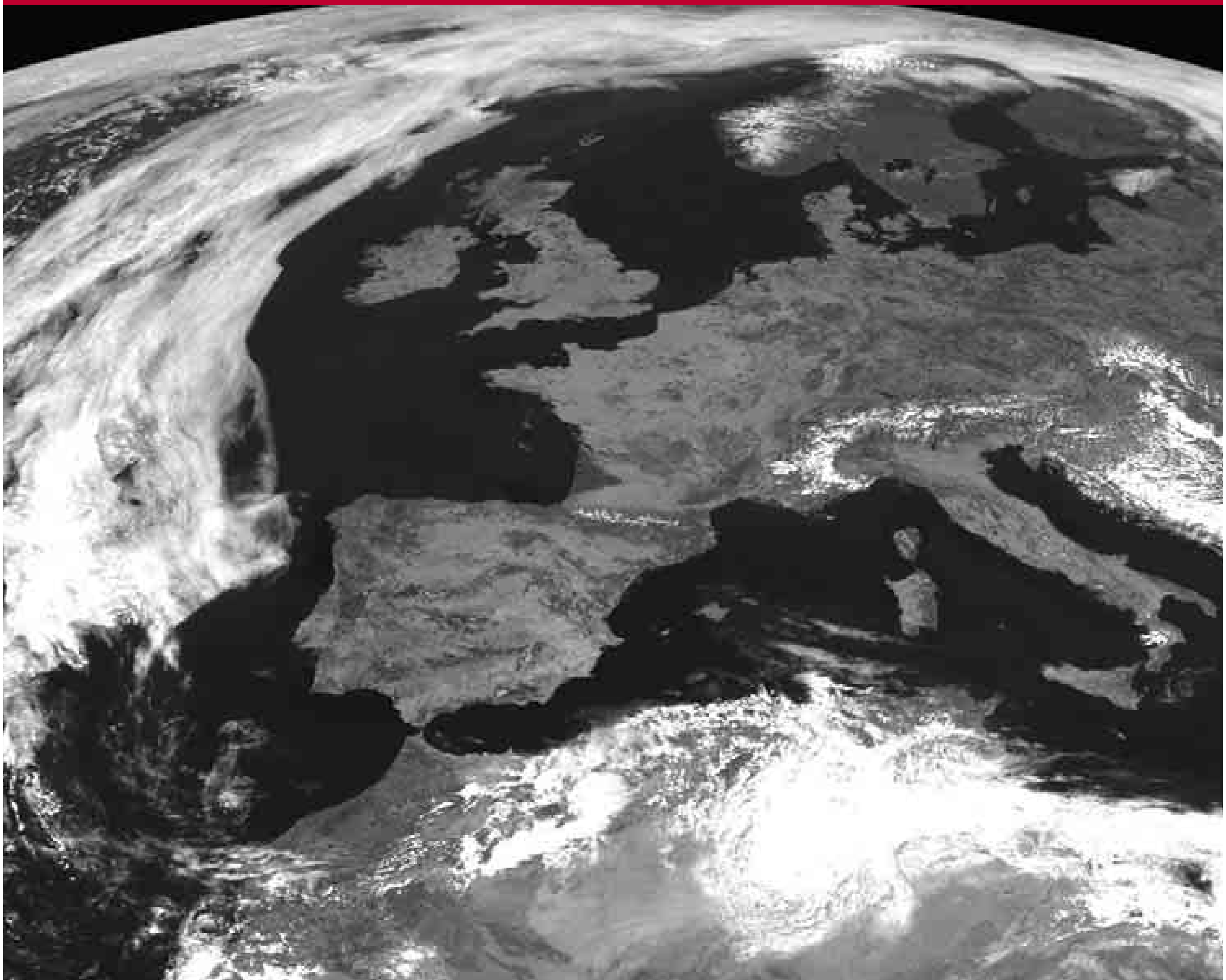
The first indicator with this aim is the Bollinger Bands mentioned above. However, sophisticated traders analyze as many indicators as they're familiar with, hoping to gain a broader understanding of the market's movement. Parabolic indicators are a sophisticated means to determine entry and exit points and can greatly aid a trader. Before utilizing Parabolic Indicators, a trader should first view the ADX, DMI, Moving Average, and Bollinger Bands. Parabolic Indicators are only useful in a trending market, which these other indicators will reveal. Parabolic Indicators is a time/price system utilizing a trailing stop and reversal method called "SAR," or stop-and-reversal. When a trader initiates Parabolic Indicators on their charting package, a sequence of dots is created. If the market is trending, a trader is able to follow these dots either upward or downward until SAR is reached and the market reverses. In an upwardly trending market, the first dot is placed when the most recent high has been broken. The first dot is placed near the most recent low price.

As the market rises, the dots will follow suit, accelerating as the trend continues. When these dots change direction, the trend has reversed and the trader should pull profits from the market. Parabolic Indicators work best for traders looking to hold positions over the medium to long term. A trader should watch the movement of these dots until they begin to accelerate. If a trader intends to open a short term position, the trend may reverse and force them to close at a loss. However, if the trader intends to open a long term position, the Parabolic Indicator is an affective means to determine when you should enter and exit the market, allowing you to capture the greatest portion of a market's trend.

Online Technology

These technical indicators represent only a fraction of the tools available to modern day Forex traders, yet surpass anything readily available just a few years ago. As a result of increasingly sophisticated charting packages, even novice traders can utilize these complex indicators. Although a trader may not understand the functions that create these indicators, they're easily able to interpret them and implement their findings.

On almost all modern day trading platforms, a trader must simply click their mouse to initiate these indicators. Saving traders the time to learn and then calculate these technical lines each time they want to enter the market allows traders to focus on more forms of analysis. Although basic trading platforms now offer a wide range of technical indicators, some traders choose to purchase more advanced charting packages. These new developments soon find their way onto the more basic platforms, improving everyone's ability to harness technical indicators and succeed in the Forex market.



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