

# IDEAS ABOUT TRADING FX

## CHARLES BELL

### Averaging In/Averaging Down

From Kathy Lien's "Millionaire Traders" Chapter One- The Art of Trading, point 7:

*"Averaging down is for losers but averaging in can be the difference between success and failure"* and what is cited as the difference? One thing: Intent.

"Averaging down" happens when the market moves against you and you panic and nervously hit the buy/sell button repeatedly-the likely outcome of this is that you end up in a position with far too much leverage than you had originally intended to use. You are now completely at the whim of the market, your adrenaline has taken over and you are frozen like a rabbit in the headlights and are now relying on luck and hope-you may as well use astrology!

"Averaging in" happens when it is already part of your trade plan to not enter all at once, to give the market room to breathe and to say "You know what? I do NOT know where the market is going to move but I think it will move in a particular direction over a given period of time and I will give myself an "area" of X amount of pips over an X period of time to be proven correct.

fig. 1

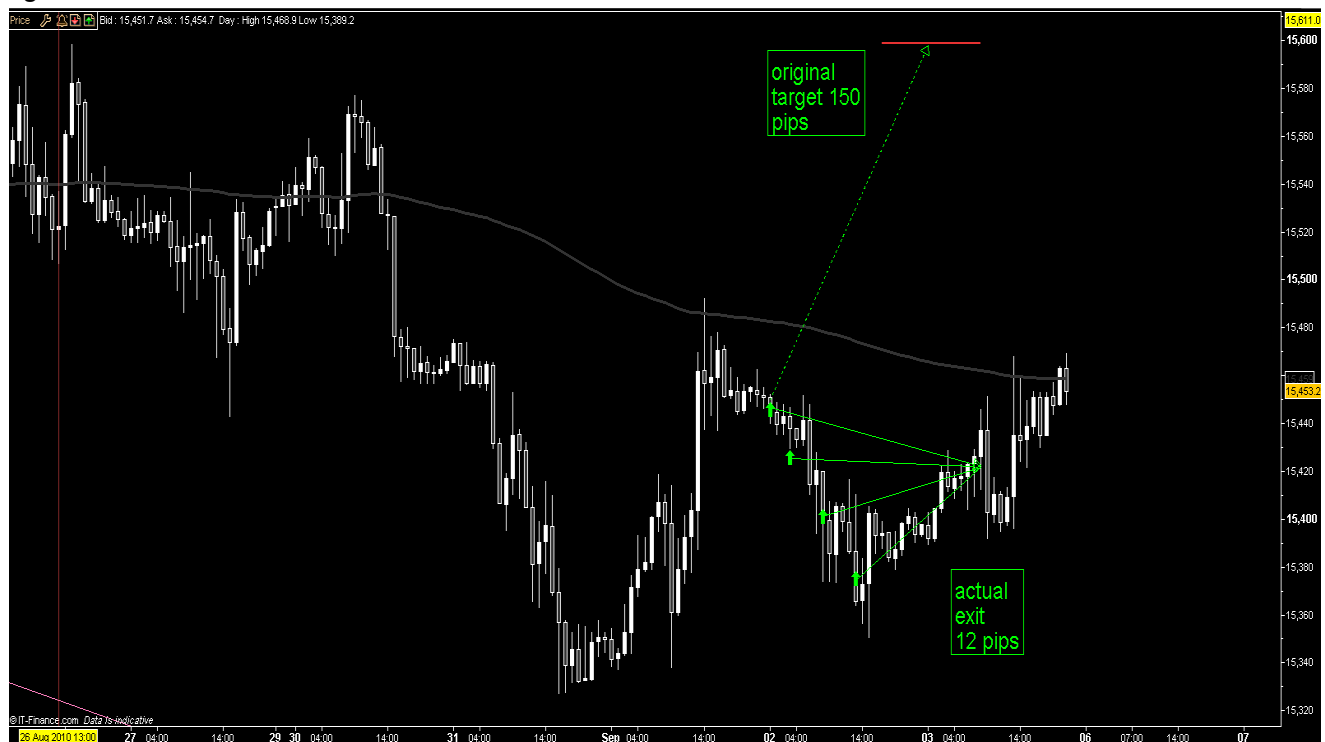


Figure 1 details a scenario of a trade idea that I implemented a couple of days ago. As you can see, I was "wrong". Had I gone in fully with the first position, I would have seen the market move against me by 100 pips and by using all my intended leverage from the beginning, the trade would likely have caused me to be very nervous, causing psychological pain that I would have

sought to alleviate. Probably by liquidating the position. The outcome would have been 100 pips loss at 4x leverage which equates to a 4% drawdown of equity.

By acknowledging the fact that I am NOT a fortune teller, whose trade idea, in this instance, could be verbalised as; "I think the market will move up from here by 150 pips and so I will enter long with 4x leverage and exit when it reaches my target", my trade idea is rather verbalised as thus; "I think the market will be higher than it is now at some point in the next 24-36 hours, and if it goes lower I will enter new positions at given points, forecasting that at some point the market will reach a point that is higher than the overall average of my total position"

What you are doing by averaging in is giving yourself multiple scenarios from which to find your profit. You are, in effect, playing 4 possible scenarios simultaneously rather than 1. I am no mathematician but you could probably express the 2 trade plans like this;

1: If  $P(\text{price}) = TP(\text{take profit})$ , then  $W(\text{win})$ . If  $P = SL(\text{stop loss})$ , then  $L(\text{lose})$   
with 4x leverage your risk is 100 and your reward is 150 giving you 1:1.5 RR ratio.  
You are aiming for 6% equity increase and risking a 4% drawdown.

You will hear from everyone that having such a RR is good, because it means for example if your accuracy is 50/50 then you will profit. Simple, right?

Wrong - the problem with this approach is that it does not take into account the "unknown" and that is the sentiment of the market as a whole expressed in terms of trades placed by the rest of the market over a certain period of time. And what drives those trading decisions made by the rest of the market? All sorts of reasons, some which are explainable eg a reaction to a news event, but there are countless others, which we do not and cannot explain.

Also the problem with this simplistic view of gauging RR, is to assume we can even accurately guess the RR! You may place a stop and a limit, and you think this defines your risk reward, but you have to include probability also as a defining factor in the calculation. And no one can define probability exactly, because the future is unknown.

2: If  $P = TP$ , then  $W$ . If  $P = TP2$ , then  $W$ . If  $P = TP3$ , then  $W$ . If  $P = TP4$ , then  $W$ . If  $P = SL$ , then  $L$ .

With this approach, even though you have entered the market with your 1st position, your entry and your TP are allowed to move WITH the market, that is, your E and TP are Dynamic.

This second method, by design, includes a 'variance in price' as a possible and likely outcome (the markets do after all, move) and allows for the impact of fundamental and technical fluctuations.

In the example illustrated in fig1, by averaging in, I have achieved approx. 30% of the original TP by spreading the E over 4 points and lowering the TP. I have achieved almost 0.5% equity increase instead of sustaining a 4% drawdown. nb, you can see that the market went higher, even surpassing the first E. To exit here would have yielded a 1.6% EQI (equity increase), but this was NFP day and I wanted to exit the market before that figure was released.

This is how to use probability to your advantage in the market. Anyone can see from the

verbalised trade plan,as expressed above,that scenario B has a higher probability of happening than scenario A,not least because B actually includes A as one of its possible outcomes.

Edit....some 6 months or so later .... Hard stops have to be in place,RR for every possible outcome has to be fully understood , at least 1:1 and risk to equity must not exceed 3%

## Trend/Reversal

Also from Kathy Liens “Millionaire Traders” Chapter 1 The Art of Trading point 9:

*“Turn Happens Only Once but Trend is Continuous”*

This statement is contrary to my strategy for the simple reason,I do *not* know how long the trend will continue but I *do* know that at some point it will finish.The key to profiting from reversals lies in setting orders at *probable* places of reversal.This can be achieved by observing trend lines and their implied points of support and resistance or by observing divergence among indicators such as MACD,RSI etc.In a ranging market I look simply at S/R.

Although I have stated in so many words that this strategy is countertrend,I will say this,it is better to trade the overall trend and to *fade the correction* rather than to fade the trend itself.

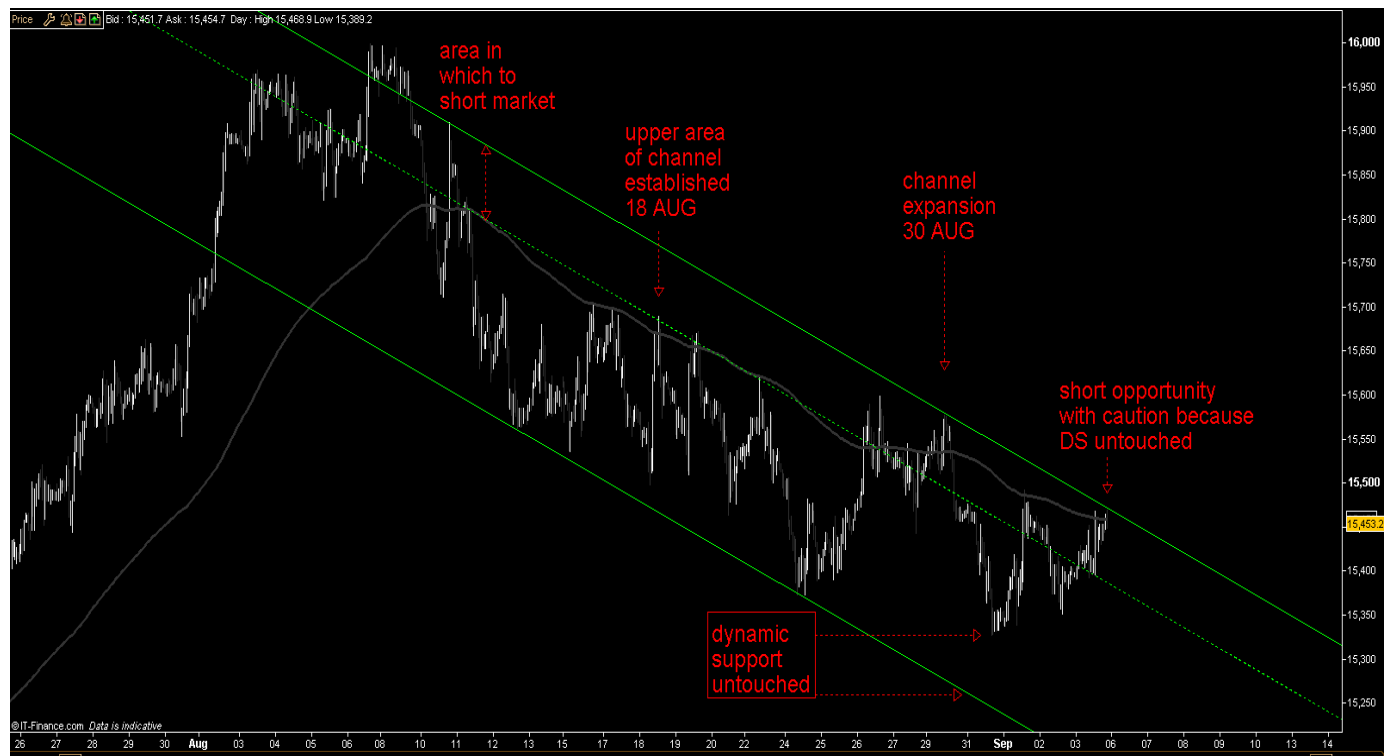


fig.2

Figure 2,above shows how the market closed at the time of writing on 3/9/10.It looks like a short because price has hit and reversed upon hitting the upper the boundary of the channel.Although,I would proceed with caution because the lower part of the channel was not reached,implying that *the rules may be about to change*.This is a 1 hr chart.

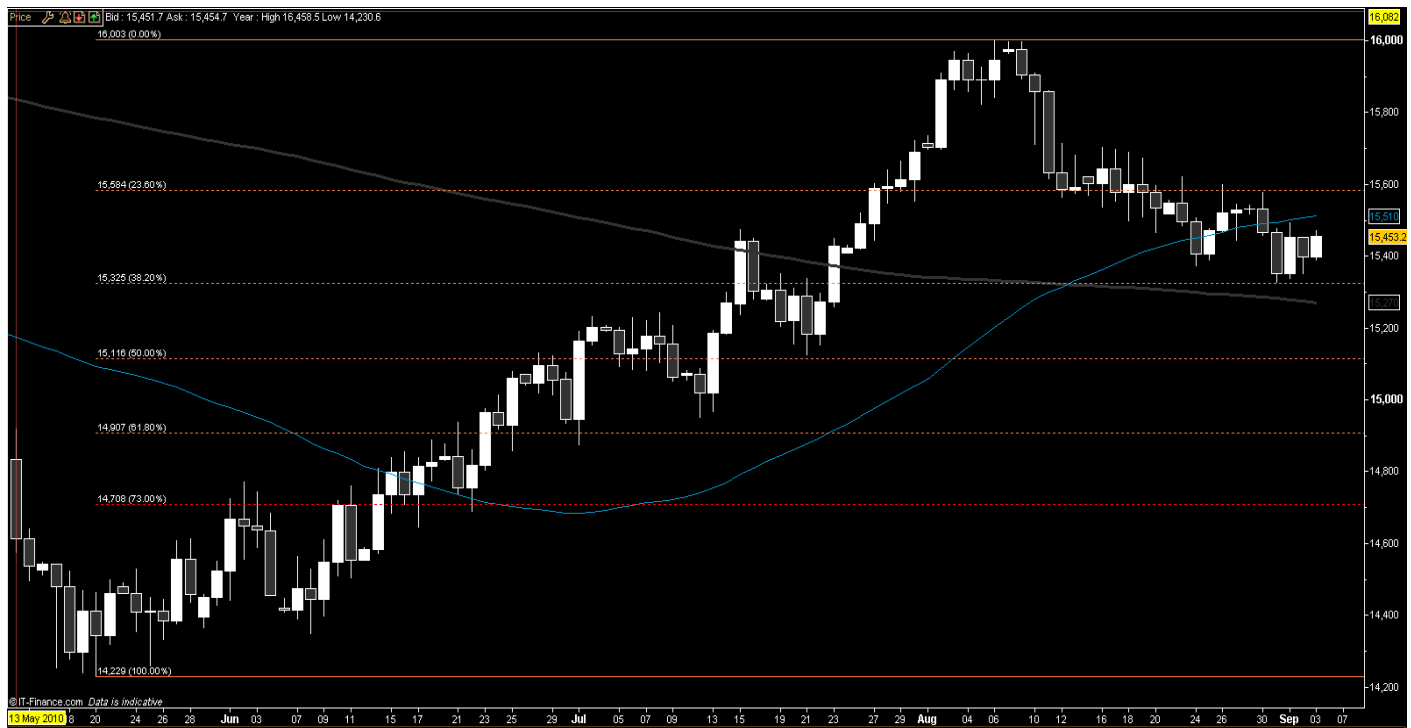


fig.3

Figure 3 shows the same market, GBPUSD, though this time on a daily chart. Not shown on the chart is the ema200 (ma200 is shown instead). Market has moved up over a 10 week period and has spent the last 3 weeks retracing that move by 38% before appearing to continue in the original direction. The market has bounced off the ema 200 *and* the 38% fib.

Also noteworthy, I believe is that the market has also bounced off the point where a Golden Cross was made (50/200 cross to the upside). A subsequent break and staying above of the 50 will confirm the end of a corrective move. Or rather will confirm, by way of retrospect *what has already happened*. A subsequent failure to break the 50 will confirm a continuation of the corrective move with the downtrend still in place. Or rather, a failure to break the 50 will confirm, by way of retrospect *what has already happened*.

What is unusual here? I am stating in so many words, that I do not know what is happening. Of course we can see price going up, reversing, then going down. We know that happened. What we don't know is which "label" to attach to the price action; "end of the correction", "continuation of the correction" or out-and-out "reversal". It is in such labelling/imagining where the confidence to implement your view in the market can be found.

Chapter 4 of MTs Chuck Hayes  
ScaleUp/Down Trader "

### The Importance of Expressing a View

The most simple view (and probably the least probable, on average) eg; GBPUSD will rise from here to 50 pips before it falls 30 - will call for one position with all the leverage you decide based on your MM.

Probably, more general views are expressed in what appears to be more complicated trade arrangements, eg, using options to express a view such as; I don't think GBPUSD will go any higher than 30 pips today which would involve a put option 30+ pips higher than the market price.

We should seek to express more likely scenarios and then base a trade plan around them. More likely scenarios may be characterized by being more general in view, such as the one above. The ability to express a view verbally and/or pictorially, I believe, gives one the confidence to enter and remain in a trade.

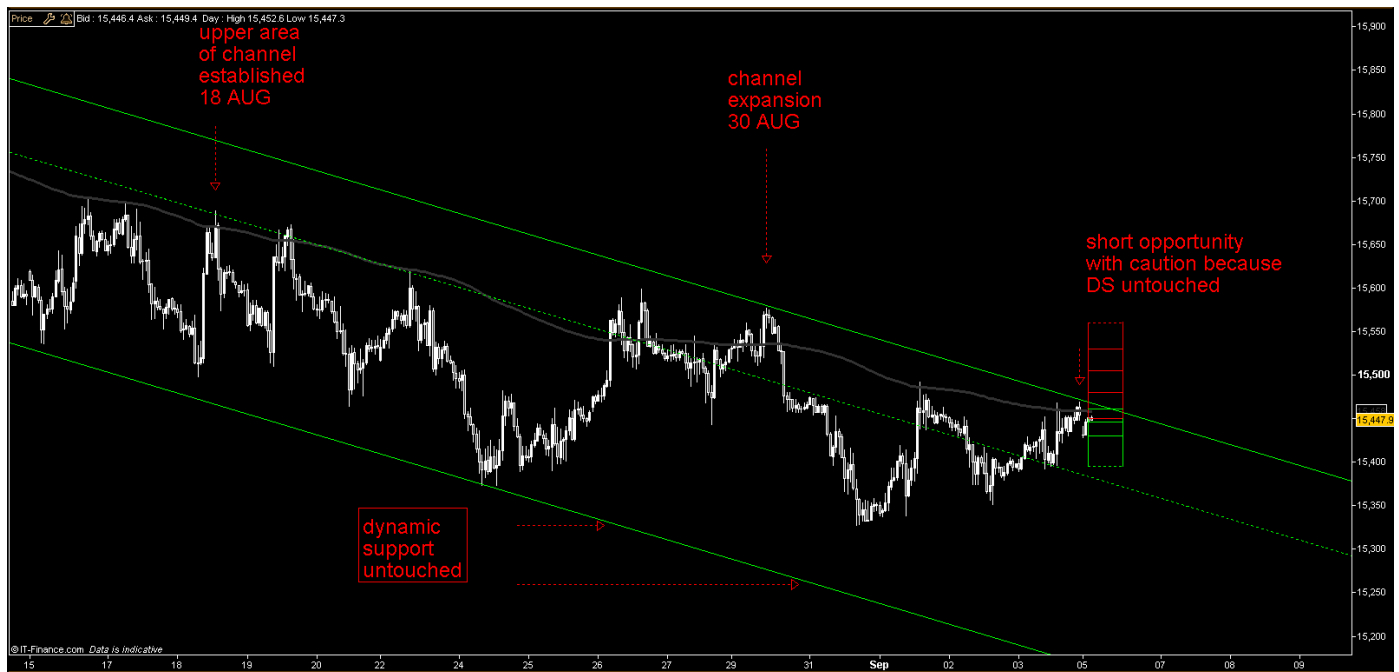
### Time Frame

It is important to consider the cycles within 1 day characterized by the opening and closing of trading centres worldwide and typical news release times. This is because they imply a general level of volatility, which we can use to our advantage. Not merely the volatility itself but also the *implication* side of things. Markets move differently at different session times and volatility is always higher at times of important news releases such as nonfarm payrolls.

This we can predict and so we can prepare for certain opportunities in the change of price action. For example, if you have been in a trade approaching 24hrs and you have not had the chance to exit on a sufficient retrace, you may not want to run the risk of another large move against you in say, the London session, and therefore would consider taking a small loss by closing before London opened.

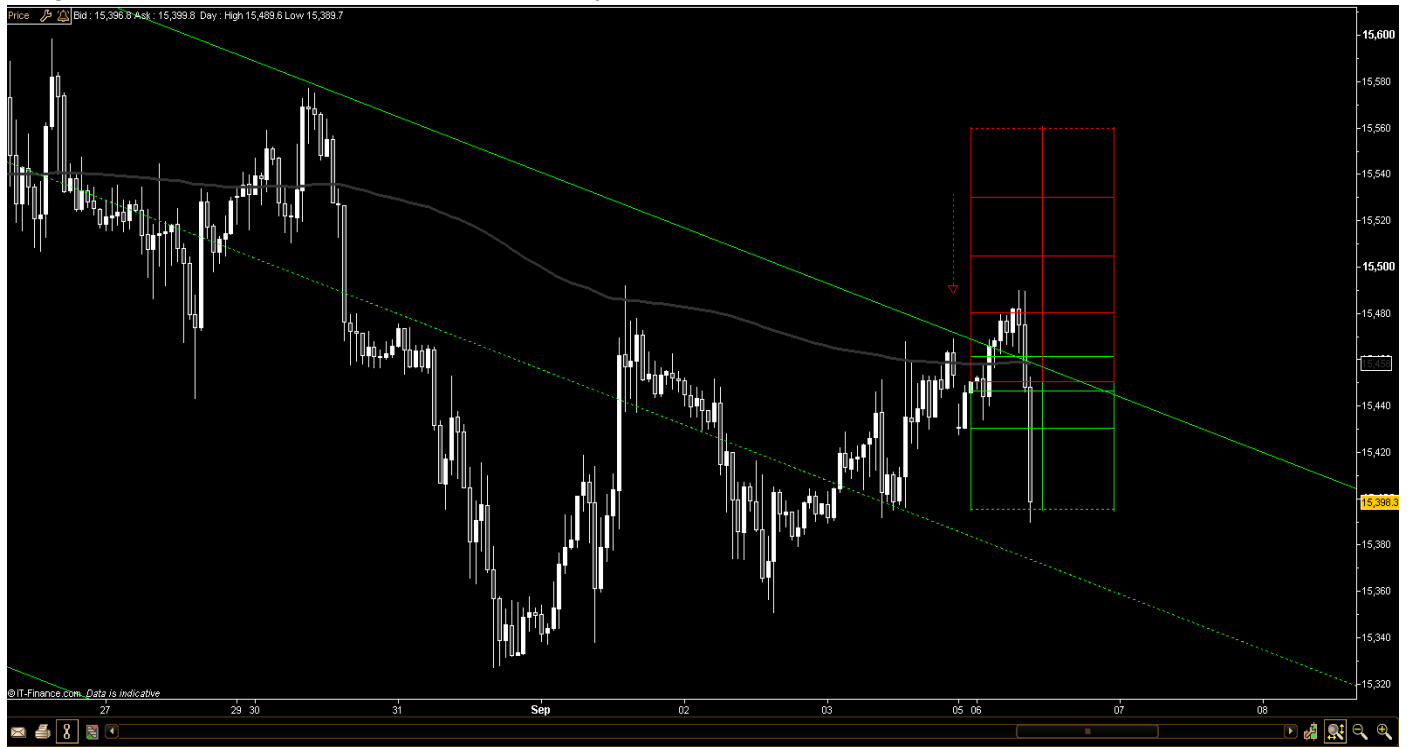
Volume

### Trade Plan



Short ladder in place for the next 12 hrs. 2330/6/9/10-1130/6/9/10

Targets are at 0.45% 0.65% 0.9% 1.3% equity increase



Target Hit.0.9%

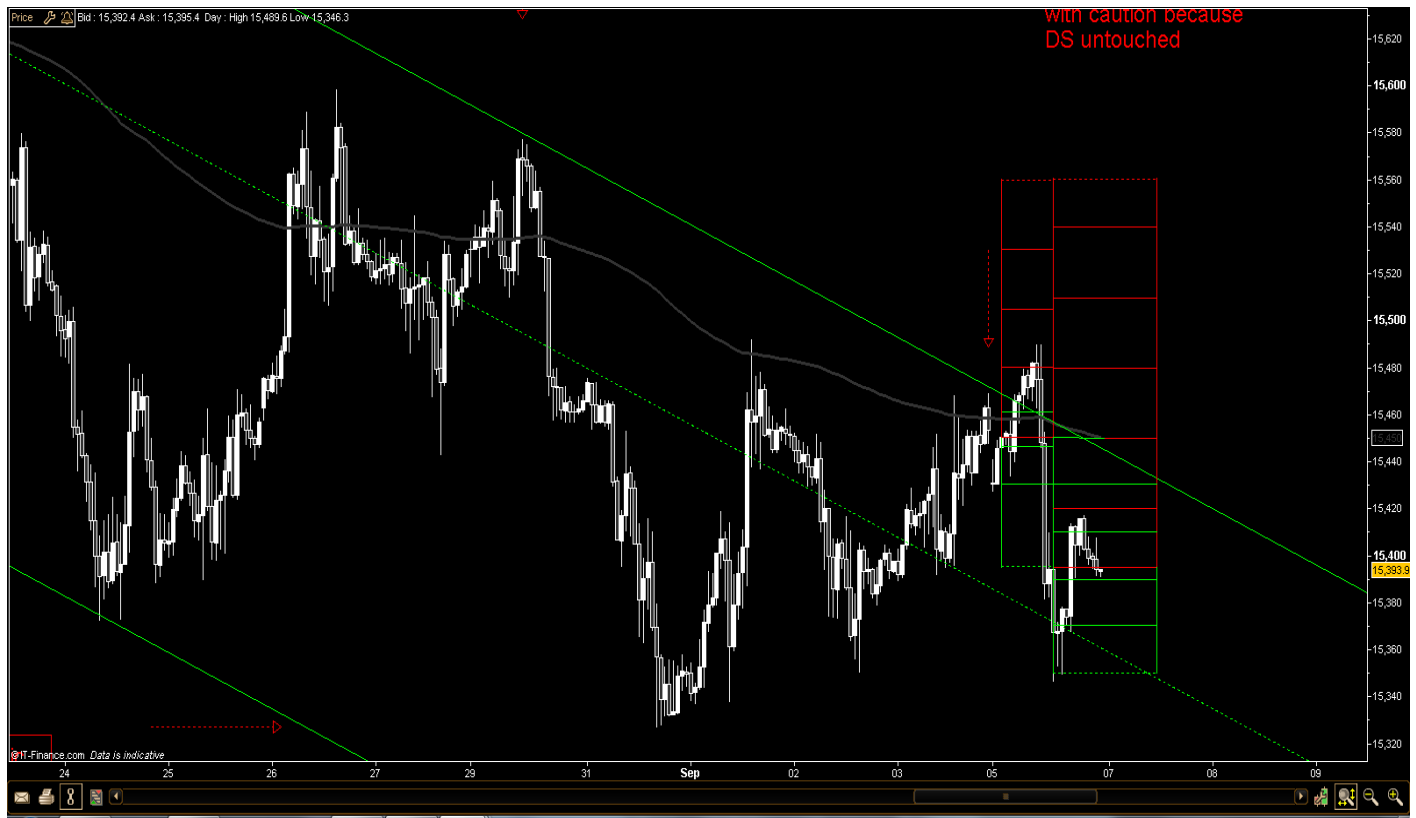
**Trade Plan**



Another short ladder in place 1600hrs 6/9/10

Position exited at breakeven ...too much leverage-stupid trading...too far beyond 155 would have bankrupted me!

**Trade Plan**



Short ladder in place from 2030 6/9/10

Price is in middle of selling zone...possibility of lower low not being made on hourly as daily support on 200 ma stands in the [way@app.15320](#)

705 7/9/10 closing one position just before target 0.35%.The rest of the ladder is open still from 15400 upwards.Position closed @ 15350.1 order 50 pips profit

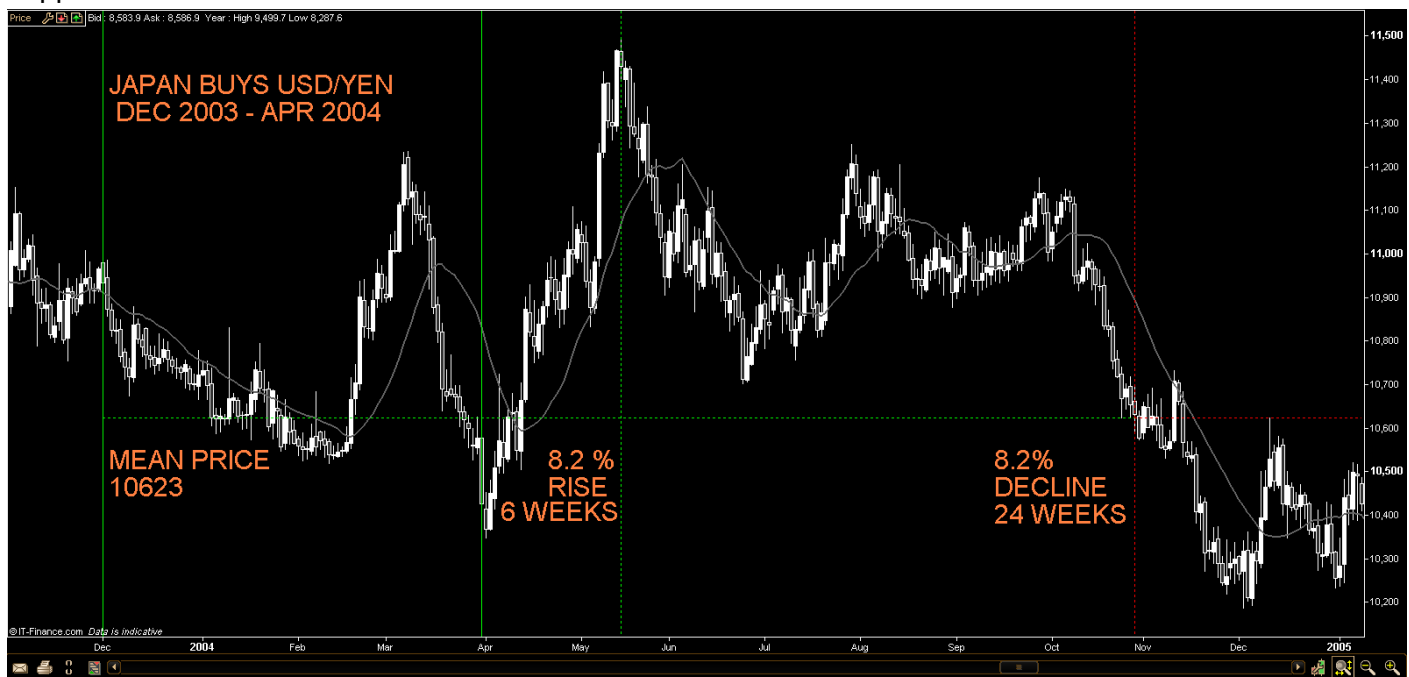
## Trade Plan



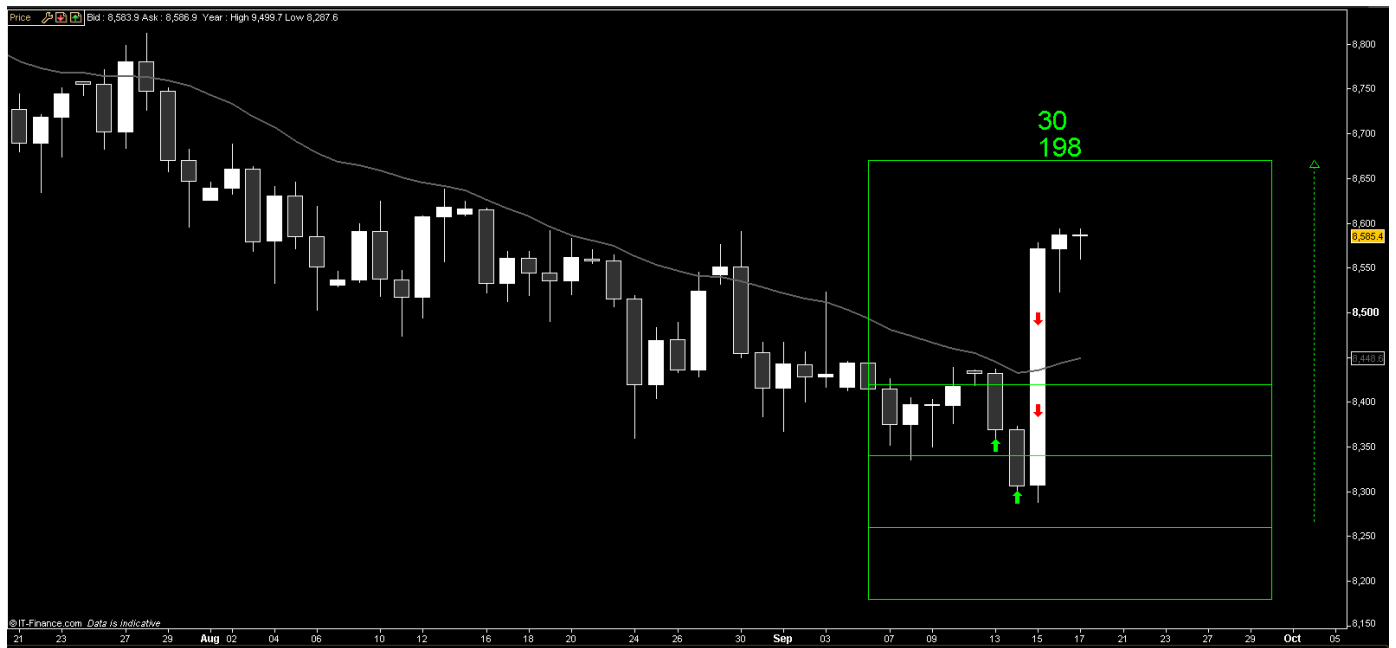


### USDJPY long ladder set for 3 weeks

Reason for this trade is that there has been some talk of state intervention in Japan's currency since they rely on a weak currency, because their economy is driven by export—a weak Yen is attractive to foreign importers. In the above chart you can see the US Dollar weakening against the Yen, going in to its 6th month of decline. The last state intervention was 2004, by the way—this happened:



## Result

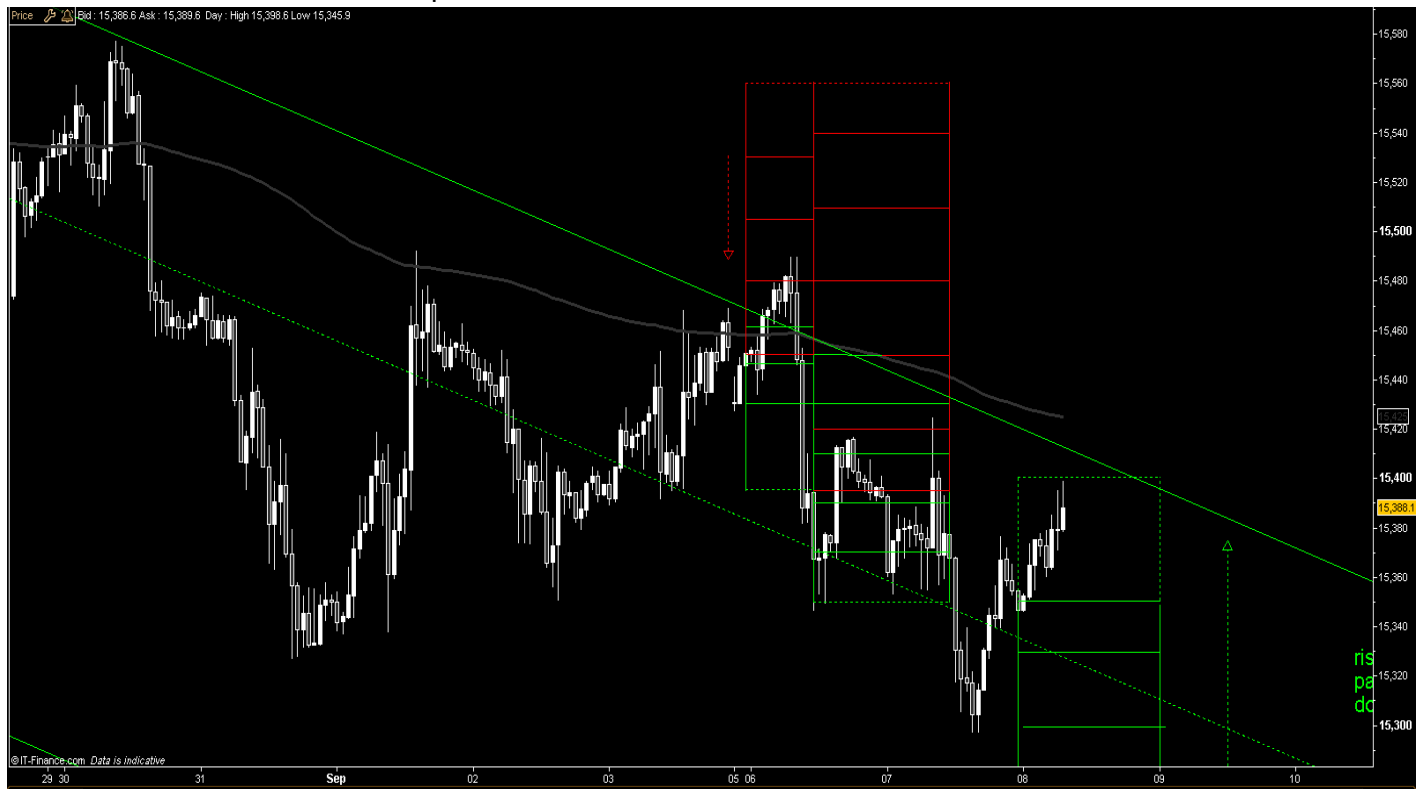


After initial entries were cancelled at around breakeven, I re-entered with 2 positions and achieved over 2% equity increase.

## Trade Plan

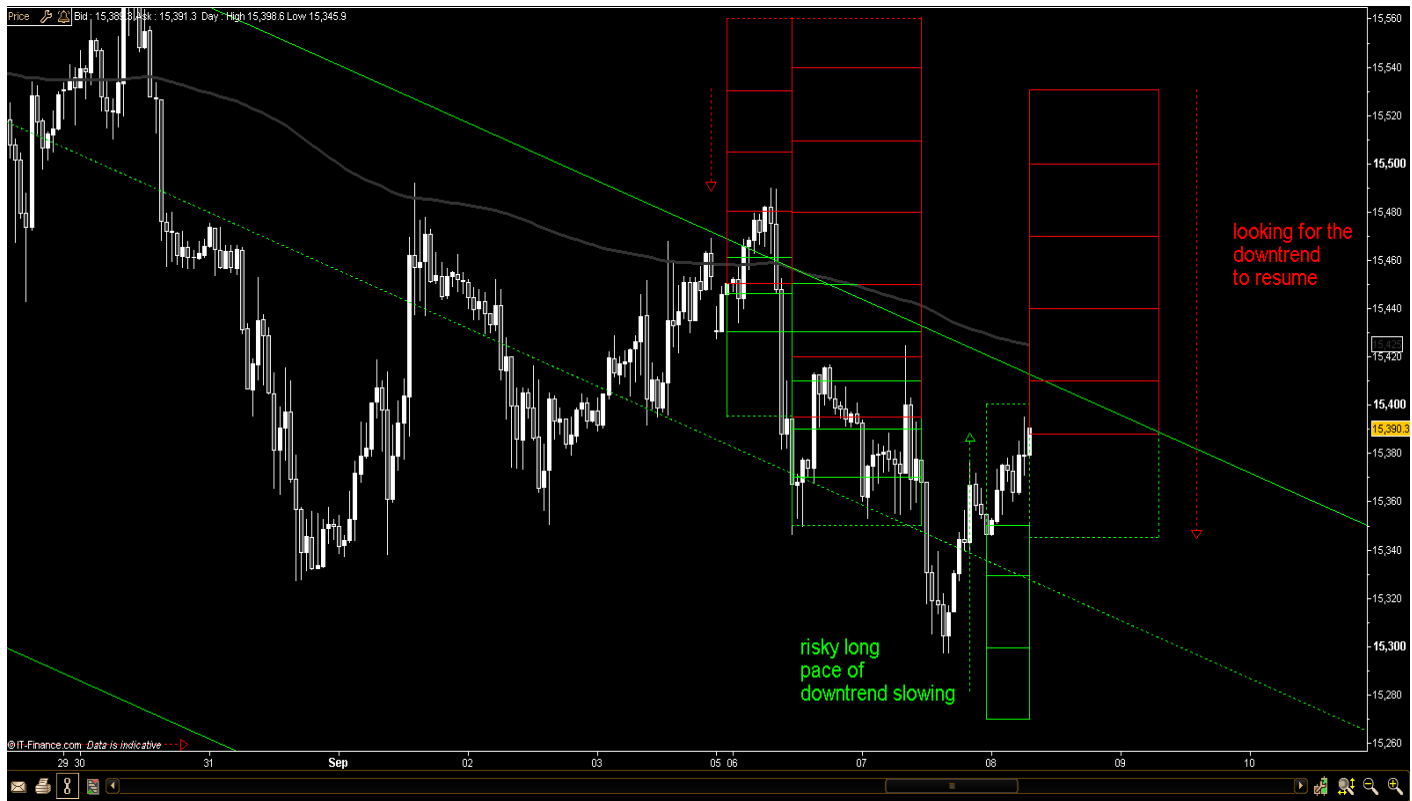


I observed the slowing of the downtrend on the one hour and anticipate either a short term bounce to 15400 or that price is now on the lower part of a new rising channel. I am willing to bet from 15270 to 15350 and take a profit between 15350 and 15395

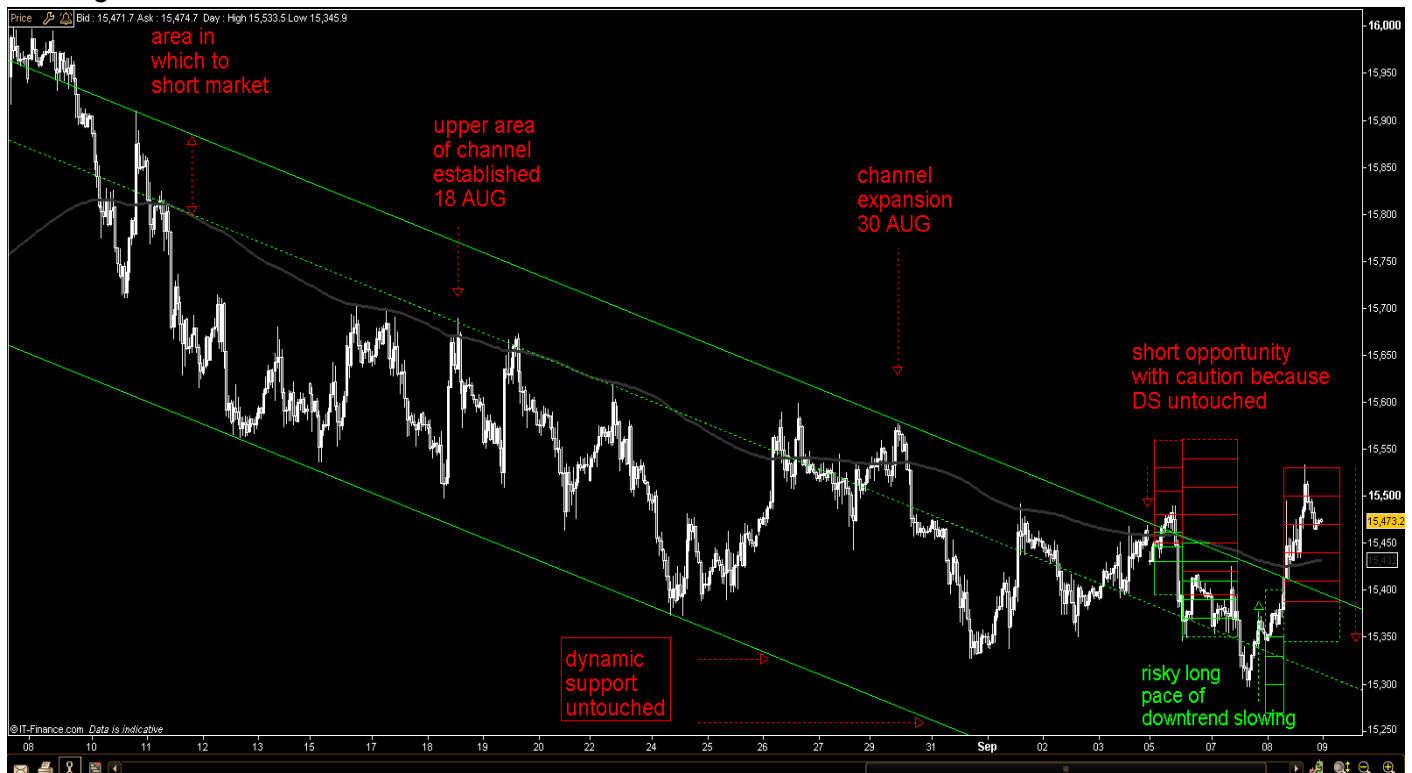


position closed 0.3% equity increase.

## Trade Plan



Looking for the downtrend to resume 0700 8/9/10-0700 9/9/10



Managed to escape this trade at breakeven. Initial analysis was right, the slowing of the

downtrend prompted a break to the upside. Left last two short orders open closed at 0.3%

## Trade Plan

[comment post 21/6 high](#)



## Result



I exited at 0.4% equity increase and re-entered at the same level, got stopped out for 0.15% loss