

## Forex Cadet Aeroplane Hanger

In this section we will explore the various instruments and tools available to the Forex Trader. The analysis comes under two types of styles; technical analysis and fundamental analysis. These could be compared to an aeroplane engine – the model or manufacture are very much like the style of analysis, one isn't necessarily any better than the other – it is more important that it is suited to the requirements of the aircraft.

Likewise in trading, the analysis style must suit the trader – this is where you will find your success.

Fundamental analysis is the analysis style of the economic factors that drive the underlying market – the Forex is highly sensitive in particular to;

- the Gross Domestic Product (GDP),
- the Gross National Product (GNP),
- Inflation,
- Employment Figures,
- and other issues such as political stability,
- financial and crisis factors.

Traders listen to news releases exactly the same as pilots listen to instructions coming from the tower at base control as they broadcast information about the flight ahead.

Technical analysis is the study of charts; price information displayed visually over time, which can be compared to the visual aids and instruments the pilot sees on his computer screens.

As you can imagine any person who has never been in a cockpit before would be utterly overwhelmed by all the buttons, lights, switches and controls. This is exactly the same for any new trader, there are actually thousands of different tools and indicators available. Market participants need to understand that you do not need to learn, and definitely not use, them all.

That old KISS principle we hear around the traps of any industry – Keep It Simple Stupid - well funnily enough it is the same in trading. So adding layer upon layer of tools and instruments can be detrimental.

Let's look at some of the basics before we go any further.

# The Forex Flight Zone





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## Bar Charts:

Most people are familiar with the good old bar charts. These show a collation of price information; the open, close, high and low for that trading session.

Historically, many traders simply used the close of the day, which over time these closing prices would be connected together by a line to create a 'Line Chart', but the bar charts give traders so much more insight into the sentiment of the market, especially when the current bar is compared with the previous or recent bars.

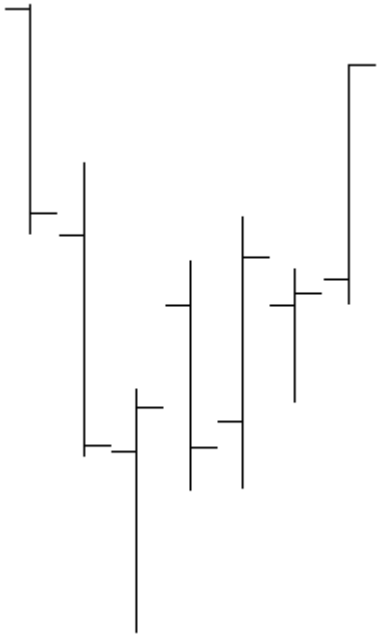
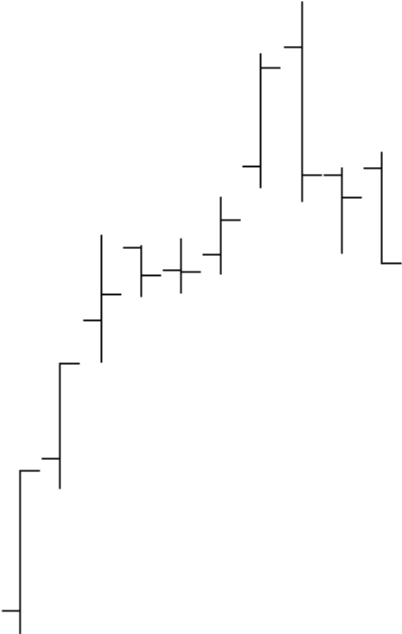
First I will discuss the individual bar types:

	The opening price is a single tick to the left, then the high and the low are connected together by a vertical line (also known as the 'trading range') and the closing price is a tick to the right.
	The distance between the opening and closing prices is important and tells the trader if the market participants are in agreement of the prices for that session – if they are, then the two prices will be close together.
	Or, if the open and close are far apart it tells the trader that one side is more dominant – the bulls will have the close much higher than the open.
	– or the bears; the close will be much further below the open.

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## Bar Groups:

Reading bars as a group, where you compare the current bar to previous bar/s can give traders insight as to where the market is likely to go.



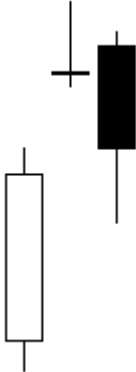
	<ul style="list-style-type: none"><li>• This group of bars started from the left by showing weakness. The first bar has its close at the bottom of a long range bar.</li><li>• The second bar follows suit.</li><li>• It isn't until the third bar that the market starts to show signs that the market may reverse. The interesting point about this bar is that initially the market opens and falls down creating a fairly long range downward. But by the end of the session it has traded upward and has closed above the open. This style of bar is known as a 'hammer' reversal pattern and is regularly found at turning points at the bottom of markets. The psychology behind it is that the sellers started but the buyers came back in force by the end of the trading session.</li></ul>
	<ul style="list-style-type: none"><li>• This next image shows a sequence of bars. Starting with higher highs and higher lows – showing the direction of the market is up. The ranges of the bars are long (strong) and the open and the closes are at opposite ends – in this case the close is higher than the open, confirming a 'bullish' direction.</li><li>• Suddenly the 'ranges' of the bars become much smaller showing indecision in the market.</li><li>• The market then breaks upward again with a strong bullish bar – but then at the top it makes an 'outside' bar (higher high and a lower low). This is known as an 'outside' reversal bar, and is regularly found to turn the market.</li></ul>

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## Candlesticks:

Candlesticks are similar to bar charts but are much more visual. Candles were developed by the Japanese and the name derived from their similar look to candles – the candle is virtually a bar (like in bar charts) but the area between the ‘open and the close’ is boxed in and looks like the body of a candle. If the high and the low stick out from the boxed in area, they look like the ‘wick’ of a candle.

One of candles great features are the common reversal patterns displayed at market turning points.

	<p>This candle is known as a ‘white’ or ‘empty’ candle. The reason it is coloured this way is because the close is above the open – showing the bulls are dominant in this trading session.</p>
	<p>This is the ‘black’ or ‘full’ candle – the close is below the open and is a clear visual that the bears or sellers have dominated this time frame.</p>
	<p>A very powerful reversal pattern that can be found at both market tops and bottoms is the ‘Doji’ candle. The Doji candle is the centre candle (trigger candle) displayed here – where the open and the close are equal or very close together. It is more effective the stronger the candles leading up to it, eg, long white candles for an uptrend, or long black candles for a down trend. The reversal is confirmed by the candle following, in this case a black candle.</p>

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This reversal is a 'Bearish Engulfing' Pattern. The importance is on the open and the close of the current bar (2<sup>nd</sup> bar) in comparison to the previous bars open and close – the current bar must engulf them.

Traders should not confuse this with the similar 'outside bar reversal pattern' where the high and low must exceed the high and low of the previous bar. As you can see in this image the body of the second candle fully engulfs the body of the first candle, but the high/low of the second candle does not need to be on the outside of the high/low of the first candle (as it would with an 'outside bar reversal').

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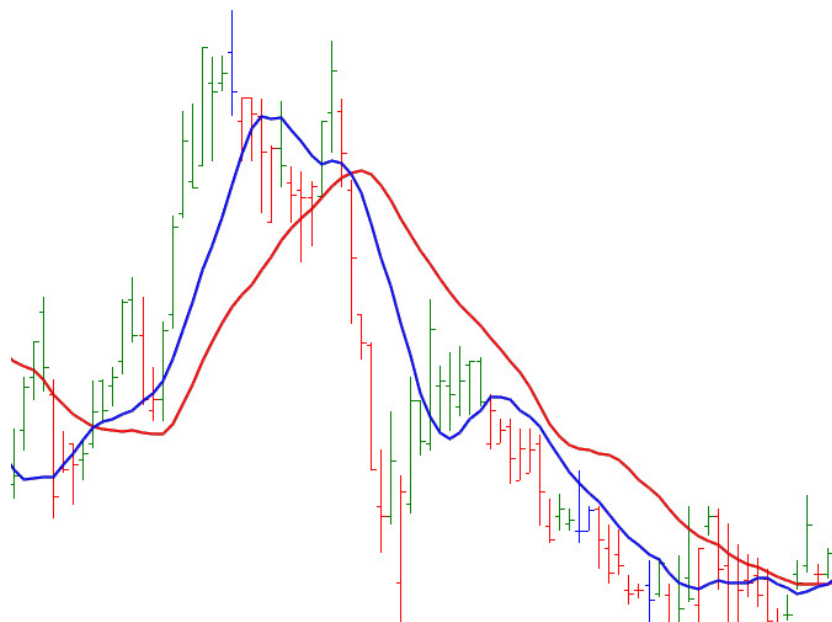
## Moving Averages:

A moving average can be used for different purposes. Their representation is the smoothing out of price activity. Indicator 'settings' can be on any of the high/low/open/close prices or a mixture of these.

The higher the number of the average of the time frame used, (eg; 21 days), the slower the moving average and less reactive to the markets movements, whereas the lower the number, (eg; 8 days) the faster the moving average and the more reactive it is to the markets movements.

Traders can use moving averages, similar to a 'Trend Line', as an entry and an exit signal as the market crosses over the other side of the line. When in a trade it works as a nice trailing stop loss, but is more suited for trending markets because in sideways conditions it can regularly cross back and forth of this line.

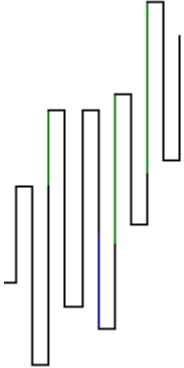
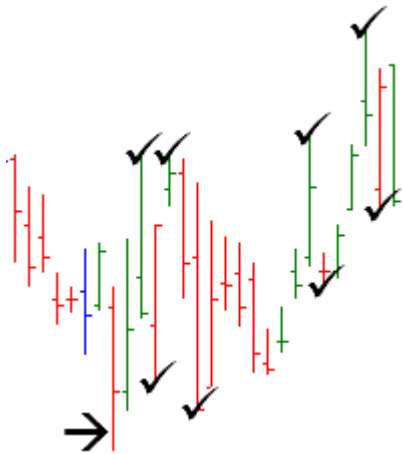
Many traders use a number of faster and slower moving averages on the one chart and use entry and exits when they cross.



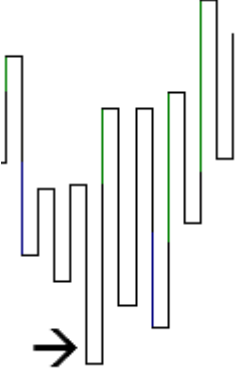
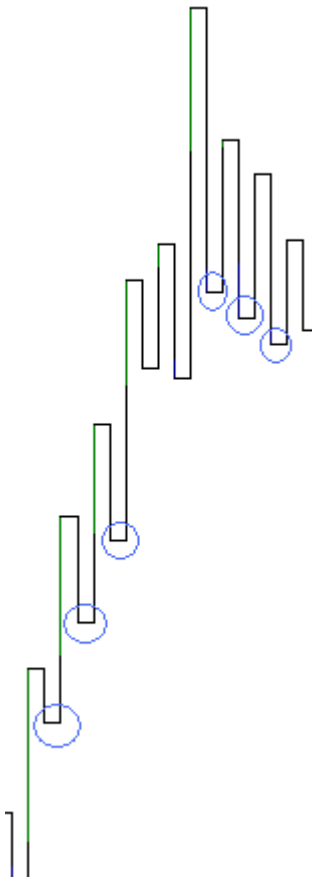
## Swing Charts:

Swing charts are a great representation of price by itself, it takes out time altogether and is represented by a single line on the chart. It doesn't plot prices over time like you see other price indicators, instead it moves upward when the price is travelling up and then moves downward when the price changes for that time period and heads down.

W.D.Gann developed the indicator back in the 1900's, it gives a good indication of the direction of the trend.

	<p>Essentially the swing chart is constructed by a single line that moves upward whilst the bars continue to create higher highs in the market then the line continues up to the highest price created.</p> <p>When the market changes direction and creates the first lower low, the line will reverse and draw a line to the lowest price created.</p>
	<ul style="list-style-type: none"><li>• Looking at these next two images you will see that there is an arrow at the lowest price in this market, and the starting point for where I will discuss how the swing chart is created.</li><li>• On the bar chart you can see from the low marked by the arrow, the next two bars moving to the right have higher highs and higher lows than the previous bar (displayed as green bars). At the top of the second green bar is a tick, this is highlighting the turn in the market (a 'peak') as the next bar has a lower low (and is represented as being red).</li><li>• The next bar makes a higher high and higher low (making it green) and swinging the market up – therefore the low of the third bar has also been highlighted with a tick (a 'trough').</li></ul>

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	<ul style="list-style-type: none"><li>• Each peak and trough (highlighted with a tick in the top image) is where the line 'swings' in this swing chart.</li><li>• An interesting point is the very last bar opened high and closed down the bottom of a very long ranged bar, and it looks very weak, but as it did not fall below the low of the bar previous to it the swing chart has not swung down and is still pointing up.</li></ul>
	<p>This image has each 'trough' in the market circled. As you can see starting from the left, each of these troughs get higher and higher as the market advances – this shows the trader the trend is up.</p> <p>On the right hand side of this image the market starts to make lower troughs, and shows the market is weakening.</p> <p>You will also notice that as the market trended upward that the 'peaks' also got higher and higher too, and when it was trending downward the peaks got lower and lower.</p> <p>Traders can use many different strategies of entries and exits within the swing charts and they also provide 'natural' levels for stop losses and trailing stop losses just underneath the troughs (long positions) and just above the peaks (short positions).</p>

## Q&A - Questions

### QUESTION & ANSWER SECTION

		Answers
<b>Question 1:</b>	The four elements that make up a Bar is the ____, ____, ____, and the ____.	
<b>Question 2:</b>	If the open and the close are close together there is agreement of prices between the buyers and sellers. True or False?	
<b>Question 3:</b>	If the range of the bar is long and the open is low on the bar and the close is high on the bar, then the bulls are d_____.	
<b>Question 4:</b>	Reversal patterns tell the trader that the market may soon reverse. True or false?	
<b>Question 5:</b>	Candlesticks were originally invented in which country?	
<b>Question 6:</b>	The emphasis of the candlestick is between which two prices?	
<b>Question 7:</b>	The 'ends' that poke out of the boxed area are called?	
<b>Question 8:</b>	A black candle is 'bullish'. True or False?	
<b>Question 9:</b>	A Swing chart looks at price only, no time. True or False?	
<b>Question 10:</b>	Higher troughs in a swing chart show the market is in an uptrend or downtrend?	

## Q&A – Answers

### QUESTION & ANSWER SECTION

		Answers
<b>Question 1:</b>	The four elements that make up a Bar is the _____, _____, _____, and the _____.	Open, High Low, Close
<b>Question 2:</b>	If the open and the close are close together there is agreement of prices between the buyers and sellers. True or False?	True
<b>Question 3:</b>	If the range of the bar is long and the open is low on the bar and the close is high on the bar, then the bulls are d_____.	Dominant
<b>Question 4:</b>	Reversal patterns tell the trader that the market may soon reverse. True or false?	True
<b>Question 5:</b>	Candlesticks were originally invented in which country?	
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<b>Question 7:</b>	The 'ends' that poke out of the boxed area are called?	The Wick
<b>Question 8:</b>	A black candle is 'bullish'. True or False?	False
<b>Question 9:</b>	A Swing chart looks at price only, no time. True or False?	True
<b>Question 10:</b>	Higher troughs in a swing chart show the market is in an uptrend or downtrend?	Uptrend