

THREE TECHNIQUES FOR SPOTTING MARKET TWISTS AND TURNS

# RIDING THE ROLLER COASTER

## LEARN TO SPOT THE TWISTS AND TURNS

Whether you're new to forex or you've been trading a while, you know how the unexpected twists and turns of the market can be thrilling, surprising and often frightening. Getting into the market without a solid trading plan and a sound foundation in technical and fundamental analysis is a little like getting on a roller coaster without a safety harness. The first abrupt change in direction is likely to throw you right out of the car.

However, one of the forex market's advantages is its tendency to trend. Like any market, it's certainly subject to periods of increased volatility and unpredictable activity. But, there are a number of tools and techniques that traders can use to both forecast potential outcomes and help manage risk in almost any market condition.

Because of its trending nature, being able to spot potential forex market tops and bottoms can be a great help in determining when and where to enter and exit the market. At Tradefair, we use a number of techniques to help forecast price movements and trend reversals.

### Relative Strength indicator (RSI) Roller Coaster Strategy

One way that you can determine a potential change in a trend on a shorter-term time frame is through Tradefair's RSI Roller Coaster Strategy.

The strategy hinges on using the RSI to alert you to overbought or oversold market conditions. It tends to be more efficient in range-bound environments, where oversold and overbought situations signify a change in the trend. Typically, when the RSI rises above 70 the market is overbought, while a reading below 30 represents an oversold market.

**Overbought** - A market that has risen to the point where it may be considered to be overvalued and may present an opportunity to sell.

**Oversold** - A market that has fallen to the point where it may be considered to be undervalued and may present an opportunity to buy.

There are just a few basic components of this strategy: To

take a long (buy) position:\*

- 1) RSI reading should be less than 30.
- 2) An up-candle should form and close, sending an RSI reading to greater than 30.
- 3) Consider going long at market on the open of the next candle.
- 4) Set profit targets and risk management levels based on your individual trading strategy and tolerance for risk.

To take a short (sell) position:\*

- 1) RSI reading should be greater than 70.
- 2) A down-candle should form and close pushing an RSI reading to less than 70.
- 3) Consider going short at market on the open of the next candle.
- 4) Set profit targets and risk management levels based on your individual trading strategy and tolerance for risk.

\*Note: This guide does not constitute a recommendation to follow a particular trading strategy. Each trade should be considered carefully as to how it fits with your individual trading strategy, including risk tolerance.

If you have any questions please contact Tradefair at +44 (0) 20 7170 0942.

This EUR/USD four-hour chart shows the RSI roller coaster in action. The pair ranges with no clear trend over the course of a couple of days. The RSI reading finally breaks below the 30 level after a temporary decline.

The RSI roller coaster strategy then sets up as the candle sends the RSI back above 30 around and triggers a potential buy signal.



Shorter-term timeframes tend to produce an abundance of potential RSI roller coaster formations. This one-hour chart shows the USD/CHF developing two setups within 24 hours. During the first formation, the RSI briefly spiked through an overbought region, breaking above 70. However, a red candle pushed it below 70, offering an opportunity to sell.

Later, a break to a fresh high took the RSI back into the overbought zone. After a short consolidation, the pair retraced (went in the opposite direction) to around 1.1835 triggering the RSI roller coaster strategy as the indicator fell below 70.



The RSI roller coaster can also work on longer time frames. In the USD/CAD daily chart, the RSI lingered well below 30 after a pronounced sell-off. However, a sudden rally helped pull it above 30, creating a potential buying opportunity around 0.9350. The market rallied nearly 1,000 pips over the course of the next few weeks.

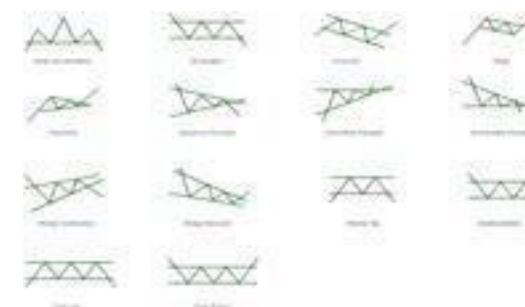
A second opportunity arose a little more than a month later, when the RSI moved into an oversold condition and then quickly fell.



The RSI roller coaster strategy is typically a low-probability/high-reward setup. You might have to endure some mediocre or even negative rides while waiting for a single great one.

Capital management is also essential, hinging on small, highly defined risks while waiting patiently for that potential big-profit trade. Half the value of this strategy is in the rules themselves, while the other half is in strict money management.

#### Stay on the Tracks with Double Tops and Double Bottoms



Price patterns on the charts can also offer opportunities to forecast market movements. In fact, double tops and double bottoms offer possibly two of the easiest purely chart-based ways to determine a potential trend reversal.

A double top is a sharp rise in the market followed by a retracement and another sharp rally to the previous levels, finally concluding with another drop. It resembles an “M” on the chart. A double bottom is the opposite of a double top, resembling the letter “w” upon completion. These patterns typically occur after a prolonged rally that takes the market to price extremes. Following the rally, a consolidation occurs and the market changes direction.



Double Top - A bearish chart pattern that may signal an impending end to an uptrend. Resembles an "M" on a chart.

Double Bottom - A bullish chart pattern that may signal an impending end to a downtrend. Resembles a "W" on a chart.

The EUR/USD chart illustrates how double top formation may be structured. Like that long first hill of a roller coaster ride, the market rallied for roughly seven months, establishing all-time highs, finally finding a top at roughly 1.60. After a marginal decline, the pair experienced a three-month consolidation followed by a second test of the previously established high. The double top was confirmed after the pair cleared a previous retracement around 1.5300, followed by a substantial decline to below the 1.4000 level.



Though the forex market is prone to trending, it's also known for reversals. In other words, what comes down will probably go up — and often in a dramatic fashion. The following USD/JPY example clearly illustrates a double bottom formation. After a prolonged decline to multi-year lows, the pair finally emerged to form the first bottom at around 87.00. A rapid retracement was followed quickly by a retest of previous lows, creating the second bottom. The pair then consolidated for approximately a week before changing the trend. Finally, the pattern and change in trend were confirmed after the pair breached the retracement level around 94.00.



No matter how much you think you know, roller coasters can surprise you with an unexpected twist, turn or loop. Forex markets can be that way, too.

Many market movements can resemble a double top or double bottom formation. As such, remember that just because a market tests the same high or low on two separate occasions, it does not mean that it automatically constitutes a viable double top or double bottom pattern. These patterns are not complete until the market breaches the previous level of retracement.

For example, triple top and triple bottom formations are another strong potential reversal pattern. Like a double top or bottom, a triple top or bottom will test the support or resistance two times. However, whereas a double top or bottom will then move through a previous retracement, a triple top or bottom returns to test the support or resistance line one more time.

One of the most common mistakes traders make when trying to identify a potential double top or double bottom is mistaking a triple top pattern for a double top and entering the market too early.

Want to learn more about how you can use chart patterns to enhance your trading? call us at 1 800 465 4373 or click here to start a live text chat and ask us about our free tool that can help you identify these and nearly 20 other patterns.

## Anticipate Potential Market Reversals with Bollinger Bands

Bollinger Bands can be another way of determining potential tops and bottoms. They are a technical analysis tool that consists of a center line enveloped by an upper and lower band, with the distance between the upper and lower bands determined by market volatility. Typically, the more volatile the market, the wider apart the bands will be.

In general, a move through either the upper or lower band indicates that the pair is either overbought or oversold. When this happens, the probability of a turn increases.

In the USD/CAD example, a clear puncture of the upper band occurs along with a triple top pattern. The technical pattern provides a confirmation, increasing the odds of a top. Following the spike, the pair falls nearly 1,200 pips.

Of course, no indicator is correct 100 percent of the time, so it's important to confirm or enhance Bollinger Bands analysis with other types of technical analysis, such as Fibonacci retracements.

You can also gain additional confirmation using the other techniques described in this guide.



Take another Look!

Trading the forex markets can bring a lot of emotions — and not all of them pleasant. Whether you're riding a rally or enjoying the free fall of a diving market, knowing when and where a market will reverse is one of the holy grails of trading.

The tools and tips described in this guide may be helpful to traders hoping to enhance their trading strategies by identifying potential market tops and bottoms. However, it's important to remember that no tool, strategy, tip or trick can take the place of solid technical and fundamental analysis. We encourage you to study the markets and develop a trading plan that best suits your individual needs and goals.

Anyone who has risked real capital trading forex can tell you that the experience of the actual ride is much different than how it may appear from afar. That's why these strategies for spotting potential "turns" in advance can be so helpful in your trading - possibly even helping you gain a new perspective on the markets.

Risk Warning: Trading CFDs, Spread Bets and Foreign Exchange carries a high level of risk to your capital with the possibility of losing more than your initial investment and may not be suitable for everyone. Ensure you fully understand the risks involved and seek independent advice if necessary.

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