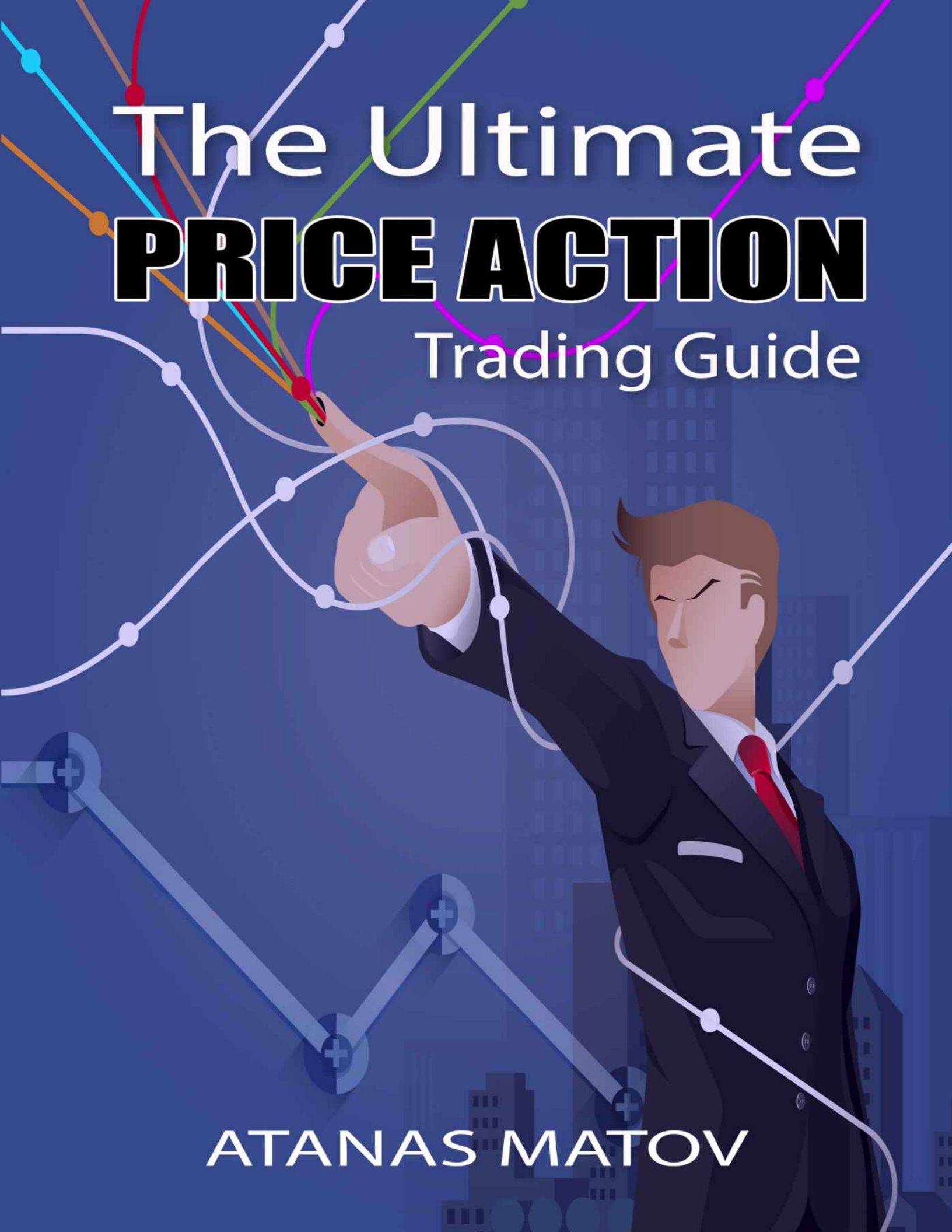
The Ultimate PRICE ACTION Trading Guide



ATANAS MATOV

THE ULTIMATE PRICE ACTION TRADING GUIDE

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FOREWORD

Over the years, we've featured many guest posts on NewTraderU.com, and by far the most popular have been posts by Atanas Matov, better known on Twitter as Colibri Trader. He writes about topics that most traders are interested in, price action and the tools to trade it systematically. His insight on technical indicators, how to identify and trade a trend, and how to visually see chart patterns have been read by tens of thousands of readers. The work and effort Atanas puts into his articles and custom illustration is a testament to his passion for trading.

With so many successful posts, I suggested that Atanas write his own book, and I'm thrilled that he agreed to be the first external trading author that we've published at New Trader U.

Atanas started his trading career as a retail trader in the early 2000's. After a few years of trading and investing his own funds, he won the KBC stock market challenge and started working for a leading prop trading house in London. He currently trades his own accounts and enjoys sharing his knowledge and experience on his website, colibritrader.com and on social media.

I enjoyed reading this book and was impressed with the great advice for trading price action that you won't see in other trading books. I think you'll find it informative and an important resource on your trading journey. Thank you, Atanas, for the time and research you put into this book.

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1

HOW TO TRADE PRICE ACTION

What is price action?

Price action is the combined characteristics that are illustrated by price movements in a specific security. Price action is typically evaluated in terms of price differences (or changes) that have occurred in the past. Price Action is best described as a technique used to observe and study the current market. It gives traders the ability to anticipate the trend and make assumptions and decisions based on current/actual price movement.

Traders who use this method should keep in mind that it relies solely on technical analysis. Price action strategies ignore many fundamentals when it comes to financial markets, instead relying more on past and present price movements.

The ability to see the market as it is rather than how you want it to be is one of the most important skills of a successful trader. Likewise, a trader must be able to overcome the fear of what the market *could* do in order to be profitable. Price action is one of the best ways to stay objective and overcome these costly challenges. I have used many trading strategies and methods, and while none of them work 100% of the time, I have acquired skills that have greatly increased my profitability.

Who can benefit from price action?

Speculators, arbitrageurs, prop trading firms and retail traders are the most common users of this trading approach, because it relies on price action signals and constantly changing market environments. Price action trading can be used in different securities.

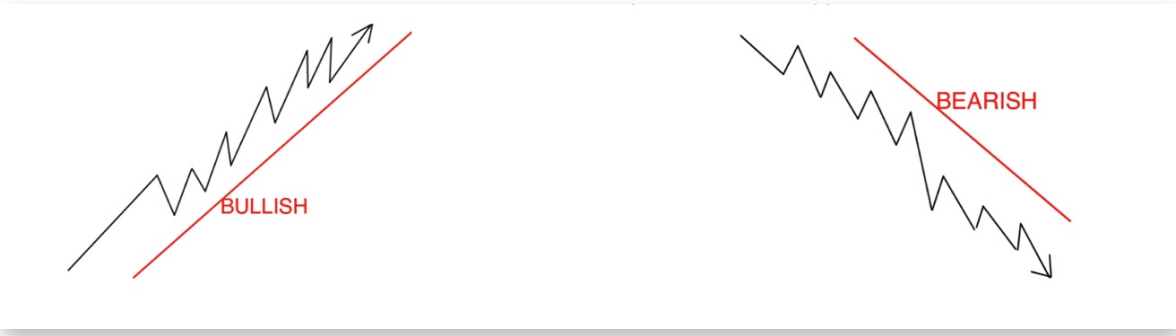
- Forex
- Commodities
- Bonds
- Derivatives
- Stocks

Price action trading – step by step

Experienced traders know that it's essential to have several options on hand for analyzing price action patterns in order to pinpoint stop-losses and entry and exit opportunities. Using only one method can be a recipe for disaster. Here is a 2-steps process you can use when analyzing a specific trading situation.

Step 1

The trader identifies the trend, whether it is bullish (rising) or bearish (falling). Then the trader identifies where the major support and resistance levels are (those levels will be discussed in detail later in this book).



Word of Caution: This step is challenging, and a trader can become confused during this process unless they are following strict, pre-written trading rules.

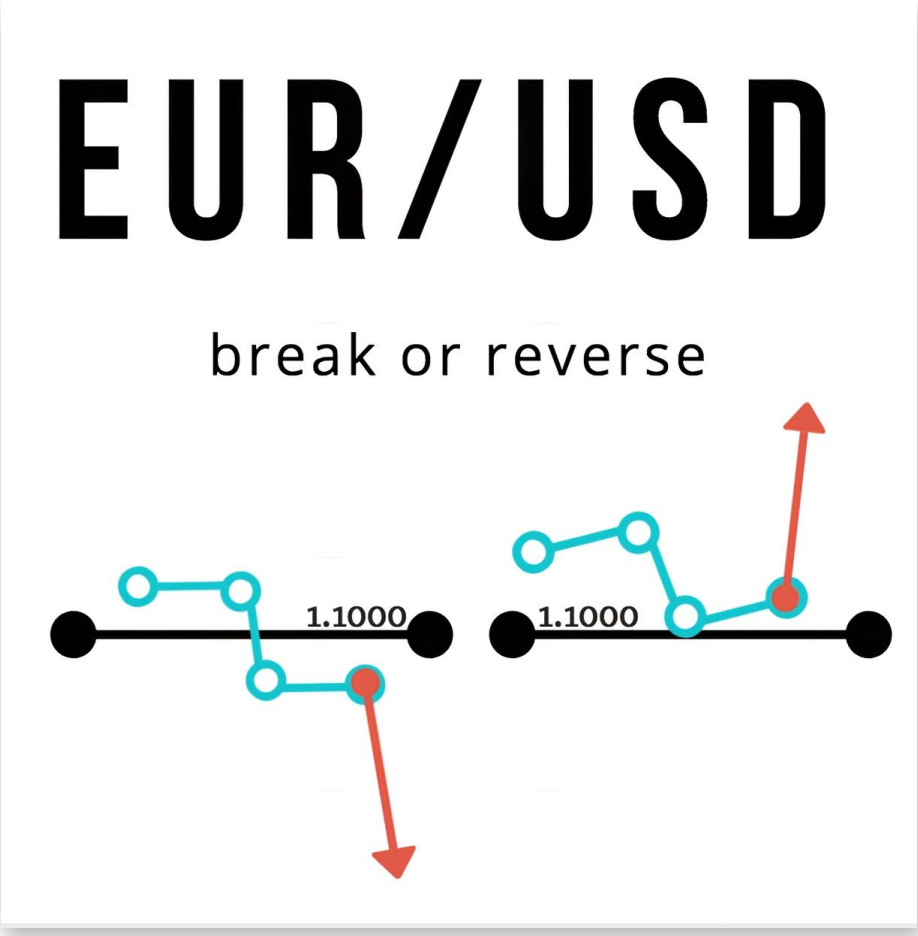
Step 2

Once the trader has completed step one, they can evaluate their opportunities. For instance, what are the chances of the security (stock or a currency pair) breaking through the support/resistance levels or reversing back**?** This step can be subjective, because while price action is supposedly an objective approach, two traders might interpret the results very differently. Therein lies the difficult and interesting nature of price action trading.

What tools can be used with price action?

There are many technical indicators available when using a price action strategy. These include trend lines, charts/graphs, price bands, low and high swings in price, support, resistance and consolidation levels, breakouts, channels, and volatility, just to name a few. While the trader may use any or all of these, their usage should be based on individual style.

A significant part of price action strategy is the trader's use of psychological and behavioral patterns to go with the flow of market actions. An example of this is when EUR/USD touches the psychological support level of 1.1000. At that point, a trader might assume that a bounce-back is imminent and take a long position in the currency pair. Another trader might assume that once price touches 1.1000, the pair could have a breakout to the downside, thereby taking a short position.



It's well established that no two traders are likely to take the same trade, in the same way, even if they use the same trading strategy. Each trader will analyze patterns and anticipate future moves differently, creating their own trading rules based on their individual risk/reward ratio within a price action strategy. However, using a technical analysis strategy can uncover common behaviors among most traders.

To summarize, price action strategy is a systematic method used to read behavioral price patterns formed by other market participants, often using technical analysis tools.

2

TRADING SUPPORT AND RESISTANCE

There are many ways to successfully use support and resistance. Here are a few of the methods that I've found to be useful.

Some traders prefer to use a candle's close for reference, but experience has shown me that the lows and highs of the candle are better indicators of where to place support and resistance levels. On the other side, a candle's close is important when defining the support and resistance zones. We'll be examining these closely in this book.

Overnight Range/Opening Range

The distance between support and resistance is the difference between the high and low values set after a candle's formation. This interval could be every hour for a day trader and weekly or monthly for longer-term traders. The longer the time frame, the more accurate the support and resistance lines will be.

Support

Support is the level at which demand is strong enough to keep price from going lower. The logic behind this is that as the price goes lower, it becomes cheaper and more alluring for market participants to buy. By the time that price is at the support level, demand will overcome supply and the price will bounce up and go higher.



There are times when the price doesn’t hold and it fails. This is an indication that the previous levels were not strong enough to prevent falling prices. As more sellers emerge and outnumber buyers, price continues to decline. After support levels break, they can become the new future resistance as a rally back to the old price support level gives traders a second chance to exit at the price level they were interested in previously.



Resistance

Resistance is the opposite of support. It's the level at which sellers are hesitant to continue buying because it's already too expensive. As buyers become more hesitant, sellers come into play and push the price lower.



However, resistance doesn't always hold. Market participants may be willing to pay even more, pushing price higher until a new equilibrium is found. Once the resistance is broken, another resistance level is formed and new sellers are established. An example from the daily EURUSD illustrates this point.



Traders typically use different levels for support and resistance. These are established by connecting the highs and lows of the previous session, or over multiple past trading sessions.

Some traders prefer to use the *close* of the candle instead of the highs/lows. This can be a good tactic, because the highs/lows are where the extreme levels are located, and where the real resistance/support levels can be found.

If you break down each daily support and resistance into its building blocks, you'll come to the same conclusion; each daily candlestick is built from the candles with lower time frames, and every daily high/low value is the close of a lower time frame's closing value.

To be more accurate, it's a good idea to find every candle's high/low rather than its closing value.

Support and resistance zones

Technical analysis is not an exact science, and this becomes clear when examining support and resistance zones. Zones are like support/resistance lines, but they encompass a larger area on the chart.



Just like the support and resistance lines, support and resistance zones are powerful indicators for buyers and sellers. This area has exchange of contracts and stop and limit orders, as well as orders waiting to be filled.

In this area, traders have an increased interest because it's a place where demand meets supply and price is in an equilibrium state. The same strategies that apply to support and resistance lines apply here, albeit across a larger area.

Remember that a trader should allow for a larger margin of error when trading support and resistance zones as opposed to single levels, and that support and resistance zones are less prone to mistakes.

Support into resistance

Another prominent feature of support and resistance is that support can turn into resistance and vice versa. Resistance is where a lot of sellers are concentrated, and once it's broken, it has the potential to turn into future support.



Once a resistance level is broken it turns into a support level. As you can see from the chart, there was an initial resistance breakout

and then a re-test, which turned this level from resistance into support. Where the change in supply and demand takes place, the new equilibrium is set.

How supply and demand price action traders think

Let’s walk through the concepts of supply and demand. This subject has gained a lot of popularity recently, and there’s good reason for that. Supply and demand zones offer insight into the structure of a market. They are like the support and resistance zones we’ve just covered, but there are certain rules that make them stand out more than support and resistance.

3

UNDERSTANDING SUPPLY AND DEMAND

What are supply and demand zones?



In this image, you see the German stock market DAX. The red zone indicates a supply zone. This could also be defined as an active resistance level, or a place where traders are selling a lot of contracts. Supply levels are broader than a resistance line and they are very similar to resistance zones.

On the other side, a demand zone is a broad area of support.



It's also a level that has a high concentration of buyers. You'll notice that every time price approaches the demand zone, it quickly jumps back up. Another characteristic of supply and demand zones is the quick price action, so if there are opportunities around those zones, they are quickly absorbed.

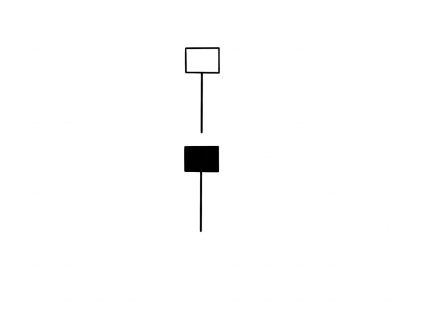
Candlesticks and supply and demand

A very important element of supply and demand trading is the use of candlestick charting. There's an entire chapter on

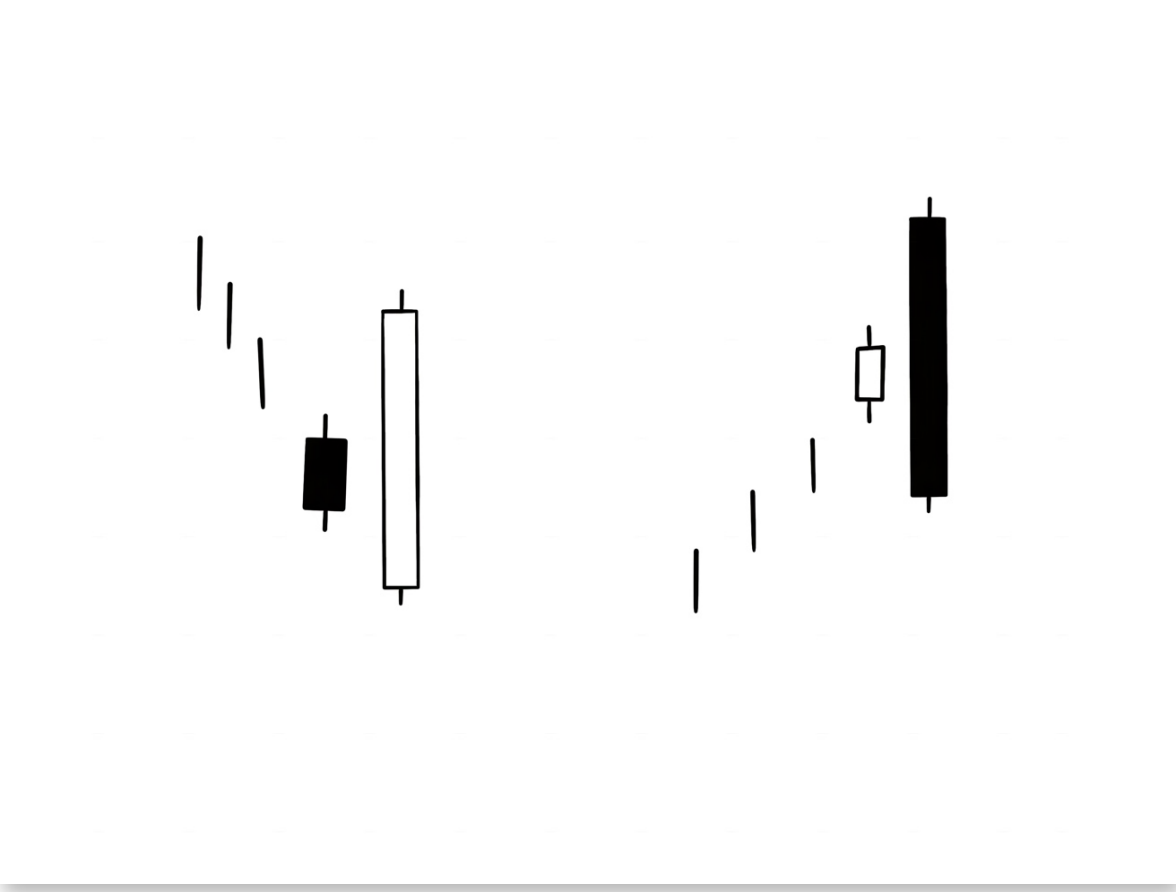
candlesticks later in this book, but I will briefly touch on them here.

The two most important candlestick patterns used in conjunction with supply and demand levels are the pin bar and the engulfing pattern. Most traders using supply and demand zones are looking for rejections or confirmations of these levels. Therefore, it's essential that you can recognize those two candlestick patterns.

Pin bar



Bullish and Bearish Engulfing Patterns





You can see on this chart of pin bar and two bullish engulfing patterns, price quickly jumps higher after the candlesticks have been formed.

Support and resistance levels vs. zones

In practice, support and resistance and supply and demand zones are similar price action patterns. Support and resistance levels are very similar to the zones. The only differences being that zones encompass a larger rea, and in the way you draw supply and demand zones. Think of supply and demand zones as big support and resistance areas with a large concentration of buyers and sellers.

Time frames and supply and demand zones

The good news is that supply and demand zones can be used with equal success on all time frames. It's still recommended that you use them on time frames higher than 60 minutes, because anything below that is subject to a lot of noise and can lead to false signals.

In my experience, the best time frames to spot supply and demand zones are the 4-hour chart and the daily chart.

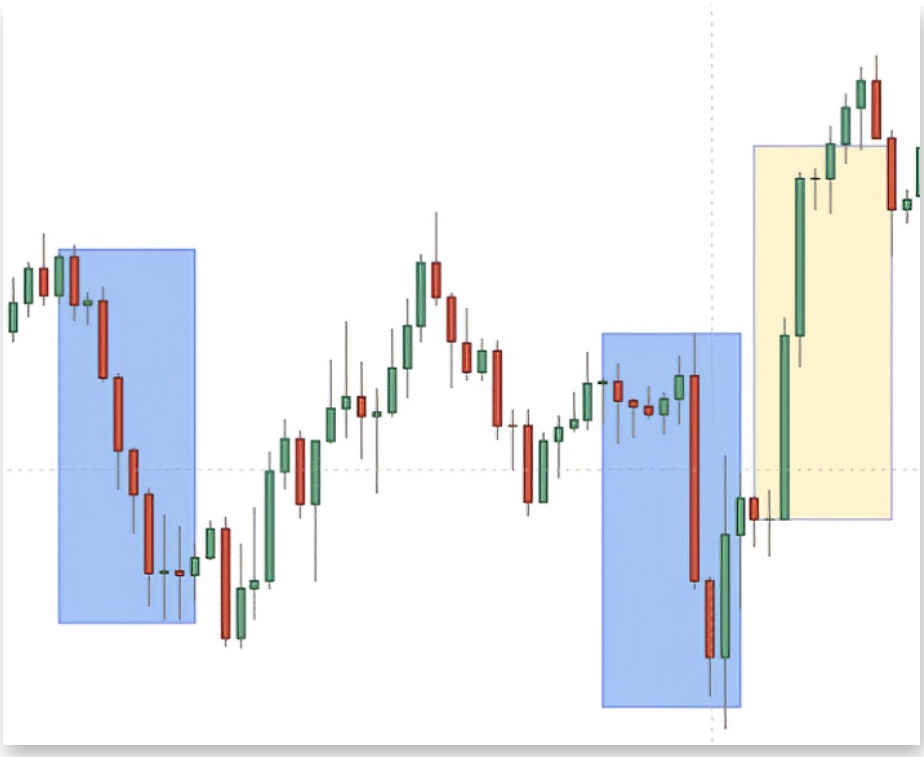
The Setup- Finding supply and demand zones

The best way to find supply and demand zones is to look at a candlestick chart.

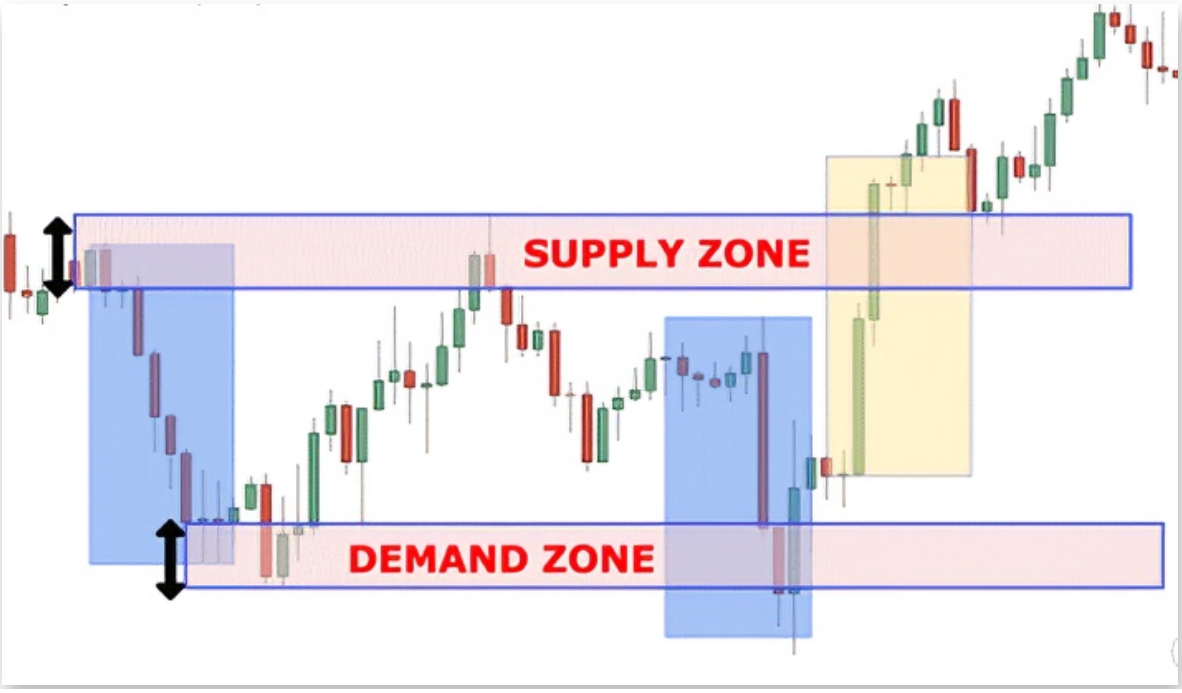
Here is what to look for to spot supply and demand zones:

- Look at the chart and try to spot many large candles in a row; it's important that price moves with momentum and speed.
- Establish the beginning price base that started the quick move.
- There's typically a small sideways move before a large move, and that's where your supply and demand zone is located.

Here is an example of large, successive candles:



Notice that the three areas indicate areas of fast-moving price action. These are the type of market moves you should be looking for. But how do we define the supply and demand zones? Let's look at another example.

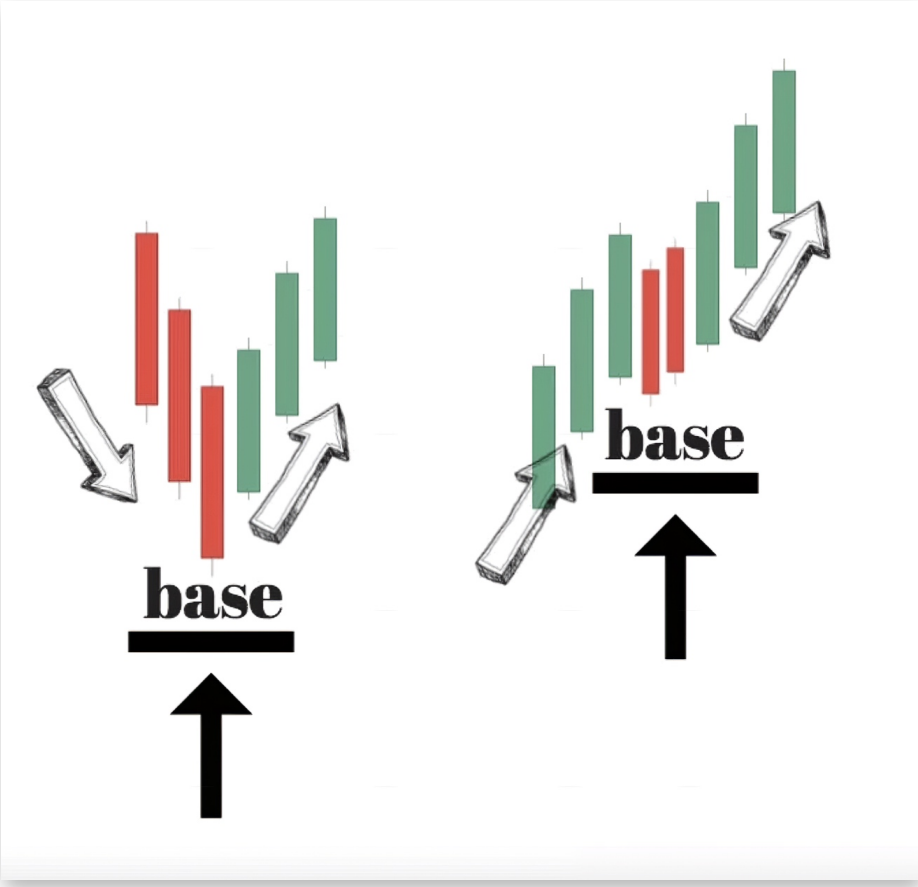


The demand and supply zones are encompassing the price base at the beginning of the move. It's difficult to be precise with those levels, and it can be more of an art than science. The good news is that with continued trading and study, you will become better at identifying the patterns.

Remember: The most important thing to look for when identifying supply and demand zones is a sharp move in either direction (up or down), after which you can pinpoint where it started from, and then roughly define the demand/supply zone.

Types of supply and demand formations

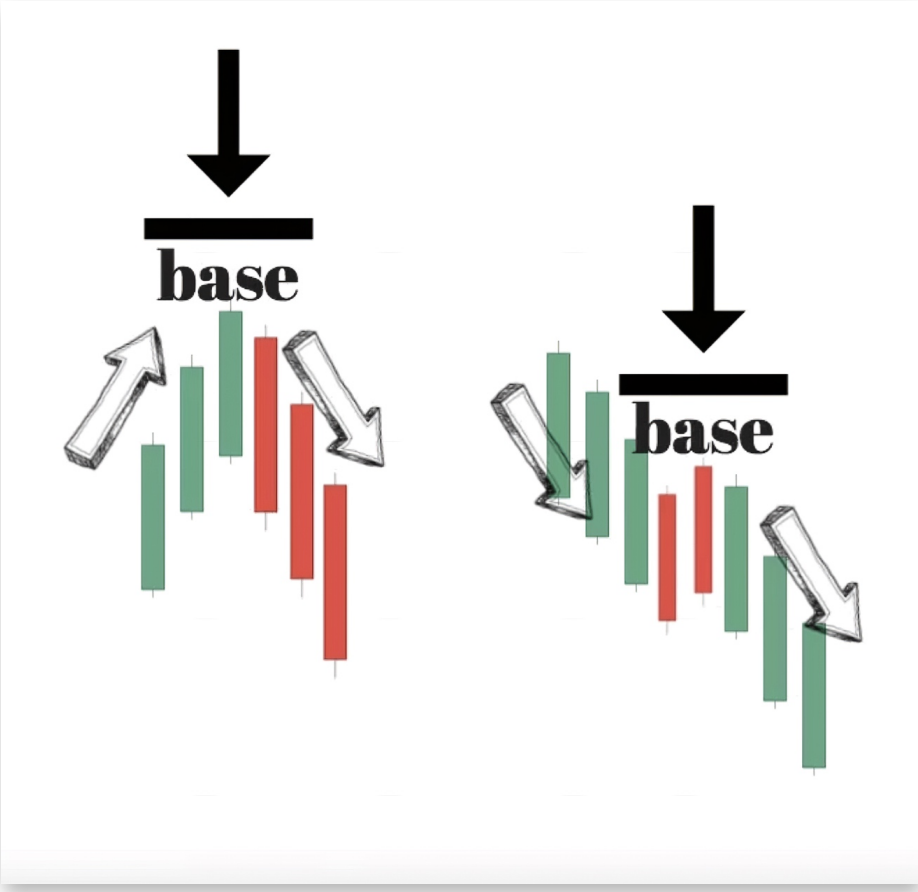
There are different supply and demand zone patterns. Some of the more popular ones are shown below.



Here are two potential scenarios. In the one on the left, price is going down (D), then forming a base (B) and then going up (U) again. We'll call this the DBU setup.

On the right side, there's an uptrend (U) first, followed by the price forming a base (B), culminating with the uptrend. (U). We'll call this setup UBU.

There are two possible setups when reviewing the supply and demand zones.



In the left image, the price is going up (U), then forming a base (B) and then going down (D). We'll call this the UBD setup.

In the right image, the price goes down (D), then forms a base (B) and after that it continues the fall downward (D). This is the DBD setup.

So, the four setups are DBU, UBU, UBD and DBD. This is how you can identify the different supply and demand zone types.

Identifying supply and demand zones

To identify these types of supply and demand formations and zones, you need to follow these three steps.

- Look at the chart and try to spot large successive candles.
- Establish the base.
- Draw the zone.

It's rare to draw a perfect zone, and it takes time and practice to be able to spot those areas. Continue to follow the rules and practice until you feel confident in drawing these levels. After a while, it will become second nature and you'll be able to spot them more easily.

Here are a few other examples of supply and demand zones.

The first example is a 4H chart of the USDCAD:



It's important to note that demand/supply zones are often including the tails of the candles. As you can see from the demand zone above, there's a large lower tail that is included in the zone.

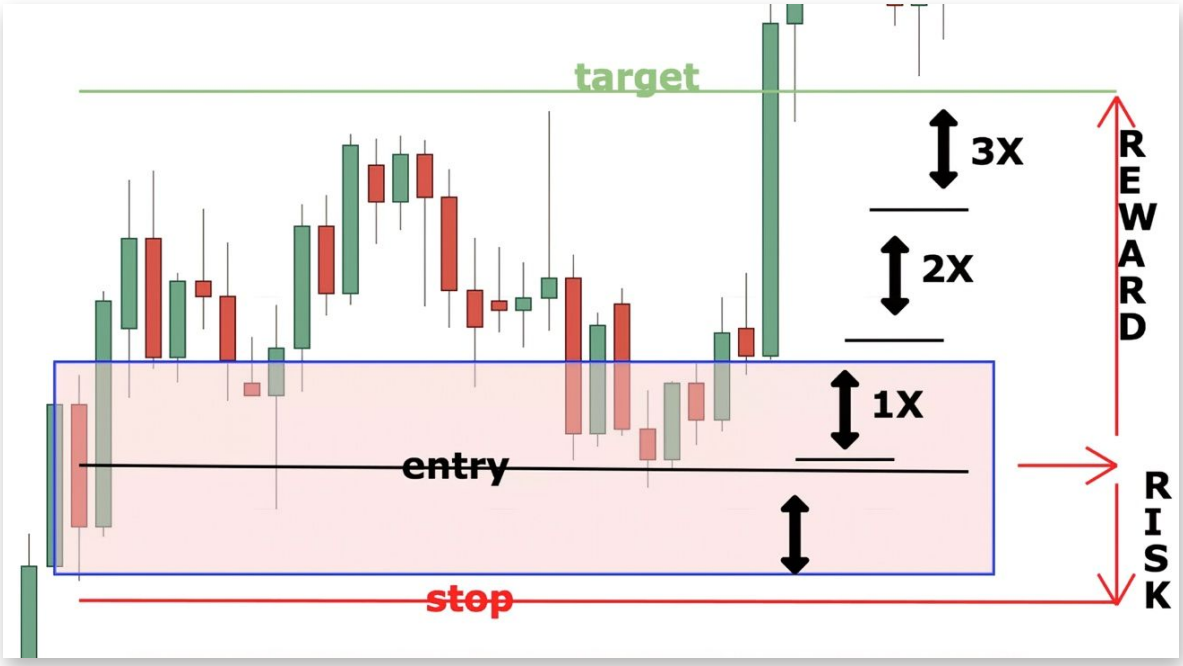
The next image is taken from the daily chart of the AUDUSD. As you can see, this is a typical Up-Base-Up (UBU) pattern.



The next setup is taken from the daily chart of the USDCAD and illustrates a typical Down-Base-Down (DBD) pattern.



Entry, stop loss and taking profit



This example demonstrates the supply and demand trading rules. This is just one way of trading with supply and demand zones. Different traders will have different rules, but it's important to focus on the risk/reward ratio.

In this example, the ratio is 1:3. The entry is usually the middle of the supply or demand zone. The stop is usually 5-10 pips below the demand zone, as indicated by the red line. Your target should be at least two or three times your risk.

These are just indicative parameters. In order to achieve profitability in trading, you'll need to spend time and practice identifying and trading these types of price zones.

4

TRADING CANDLESTICKS

Candlesticks are obviously an important tool used by price action traders, so we'll take a look at how traders identify and use candlesticks.

While everyone is familiar with the conventional line and bar charts on traditional stock charts, the candlestick chart is a variant that has been used for about 300 years to display more information than a conventional chart. The candlestick is a vertical, square or rectangular showing the period's trading range. A wide bar on the vertical line illustrates the difference between the open and close. The thin lines at the top and bottom on each candlestick are the 'wicks' showing the daily range outside the open and the close.

Note: The daily candlestick line contains the currency's value at open, high, low and close of a specific day.

THE CANDLESTICK HAS A WIDE PART, WHICH IS CALLED THE ***REAL body*****.** This real body represents the range between the open and close of that day's trading. When the real body is filled in or black, it means the close was lower than the open. If the real body is empty, it means the opposite, the close was higher than the open.

Candlestick charts

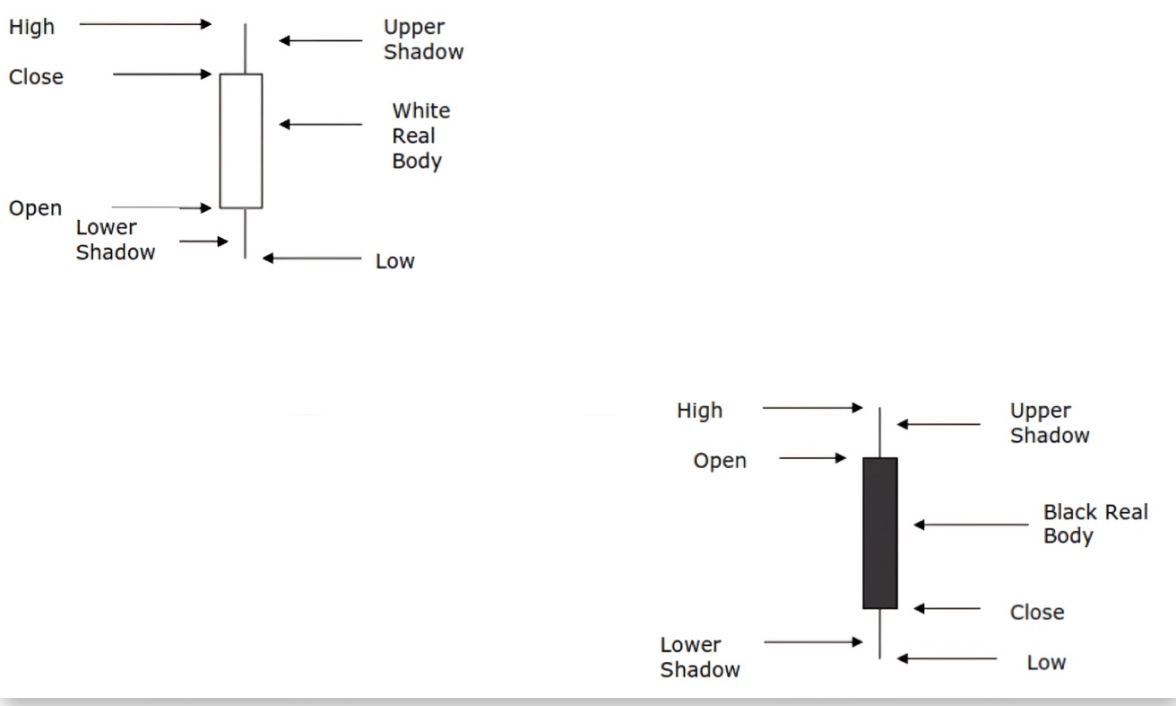
Just above and below the real body are the *shadows*.

Chartists think of these as the wicks of the candle, and it's the shadows that show the high and low price of that day's trading. When the upper shadow (the top wick) on a down day is short, the open that day was closer to the high of the day, while a short upper shadow on an up-day dictates that the close was near the high.

The relationship between the day's open, high, low and close determines the look of the daily candlestick.

There's a wealth of information displayed on each candlestick. For instance, with a quick glance you can see where a currency is opening and closing, high and low values, and whether its close is higher than its open.

The major candlesticks that price action traders use



There are many well-known candlestick patterns in the trading field, and while I won't go over all of them, we're going to walk through three of the most prevalent used by price action traders. Visit my website at colibritrader.com to view the full list of candlestick patterns.

Pin Bar

Pin Bar or Hammer signals a reversal after a downtrend when control has shifted from sellers to buyers. The shadow should be at least twice the height of the body. If it occurs after an uptrend, it's called a *hanging man* and is a bearish signal.

For a pin bar to form, traders look at the real body to be relatively small and the tail of the candle to be much longer; the longer the tail the better. While not a general rule, savvy traders look for the the tail to be long enough for the real body to fit into it at least two times.

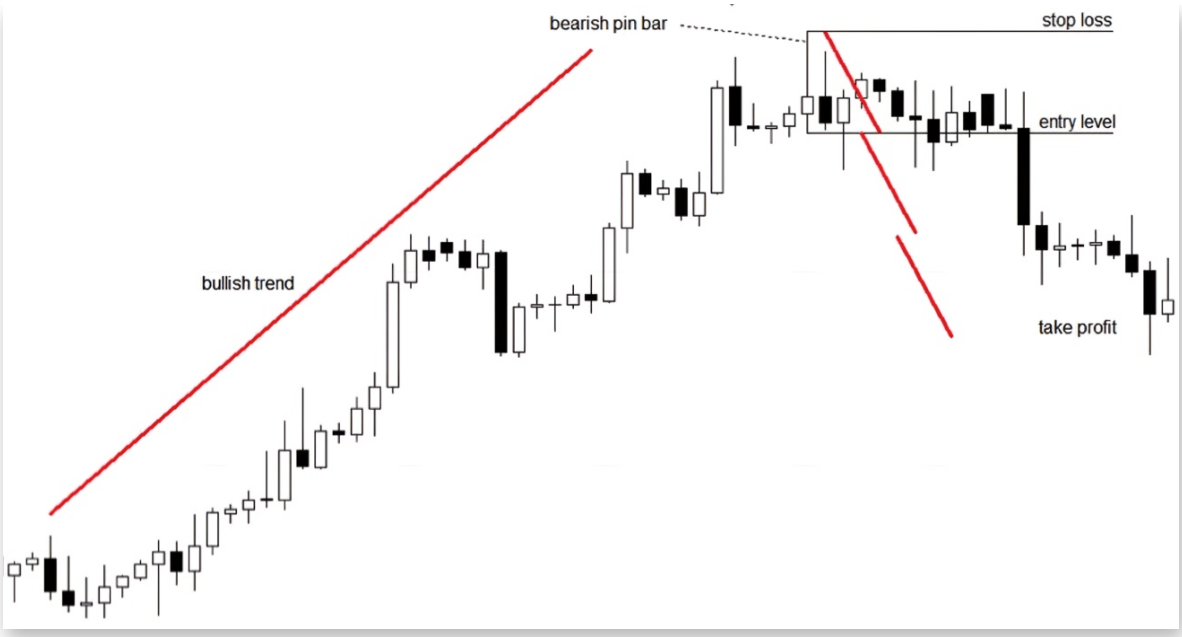
Conventional wisdom claims that a bullish pin bar must have a green body (closing price bigger than the opening one) and a bearish pin bar a red body (closing price lower than the opening price).

The pin bar setup

For a single candle, the pin bar is an impressive reversal pattern. It shows a battle between bulls and bears, signaling that the previous trend has weakened. For a bullish pin bar, a bearish trend must exist, and a bullish trend is mandatory before a bearish pin bar reversal signal.

A pin bar trading strategy signals when it reverses a bullish trend based on the following steps.

- Measure the entire length of the pin bar, from the lowest to its highest point.
- Go short when the price breaks the lowest point.
- Place a stop loss order at the highest point in the bearish pin bar.
- Project the length of the pin bar reversal a minimum of two times below the entry point.



Pin bar trading in confluence areas

When two or more technical indicators point to a reversal from the same area, the market is said to form a confluence zone. Such areas are strong resistance or support points and are difficult price areas to breakthrough. Typically, the higher the time frame, the stronger the area of resistance.

A confluence area could be a support or resistance level, coupled with another technical pattern. For example, if the market forms a double bottom on an area that previously acted as a support level, that's a confluence area.

Pin bars also represent strong areas of price support or resistance in price action on charts. When a pin bar forms as part of a pattern, the market signals a strong potential for a reversal from that level.

Two common strategies for trading pin bars

Strategy 1

Price action traders typically use candlesticks in conjunction with chart patterns. One of the more popular such patterns is the falling/rising wedge.

A falling wedge is bullish and a rising wedge bearish signal shows weakness. During a wedge formation, the price action is confusing, to say the least. The market continues making higher highs and higher lows (in a rising wedge); or lower lows and lower highs (in a falling wedge) with no hint of the imminent change. The trend lines of a wedge give its shape, converging towards a merging angle until the wedge breaks.

Before the price breaks the wedge it's common for it to pierce the opposite trend line. If/when it does, traders look for a pin bar (or another candlestick pattern). It's a confirmation that the market will reverse, and because it's a confluence area, the pin bar works as a confirmation at this area.



This chart explains the confluence of the two bearish patterns. The market rises in a bullish trend, forming a series of higher highs and higher lows. However, the follow-through is only marginal. When the price pierces the upper trend line, it forms a bearish pin bar.

In fact, it forms two consecutive bearish pin bars. The first piercing of the trend line is a bearish pin bar too, invalidated by the future price action. The market fails to advance and forms another pin bar. This time, the rejection is firm, and the next candle breaks

the wedge. Traders then focus on trading the rising wedge, following these rules.

- Go short when the wedge breaks.
- Place a stop loss at the top of the wedge (highest point in the bearish pin bar).
- Measure the risk and project a minimum 1:3 risk-reward ratio.



Strategy 2

Trading a pin bar with dynamic areas of support and resistance is another way to use this candlestick.

Typically, support and resistance form horizontally. This is the easiest way to spot support or resistance areas. However, dynamic support or resistance levels are more difficult to break. They rise and fall with the price action, offering exceptional places to add to an existing position when trend trading.

To find dynamic support or resistance levels, we need to draw a trend line that closely follows price. The line of a trend connects two points, and then traders project it further to the right side of the chart.

In a bullish trend, the key is to identify a series of higher highs and higher lows and connect their extremes. Be careful with the

number of times the price tests a trend line. In principle, the more times price touches a trend line, the weaker the trend becomes.

A pin bar is a single candle. When it forms against a trend line and moves in the direction of the existing trend, it signals a continuation pattern and not a reversal. It reinforces the bullish trend, and the market usually goes higher. Multiple retests show a weakening trend, and traders should avoid or reduce their trading position the third or the fourth time a dynamic support or resistance appears.

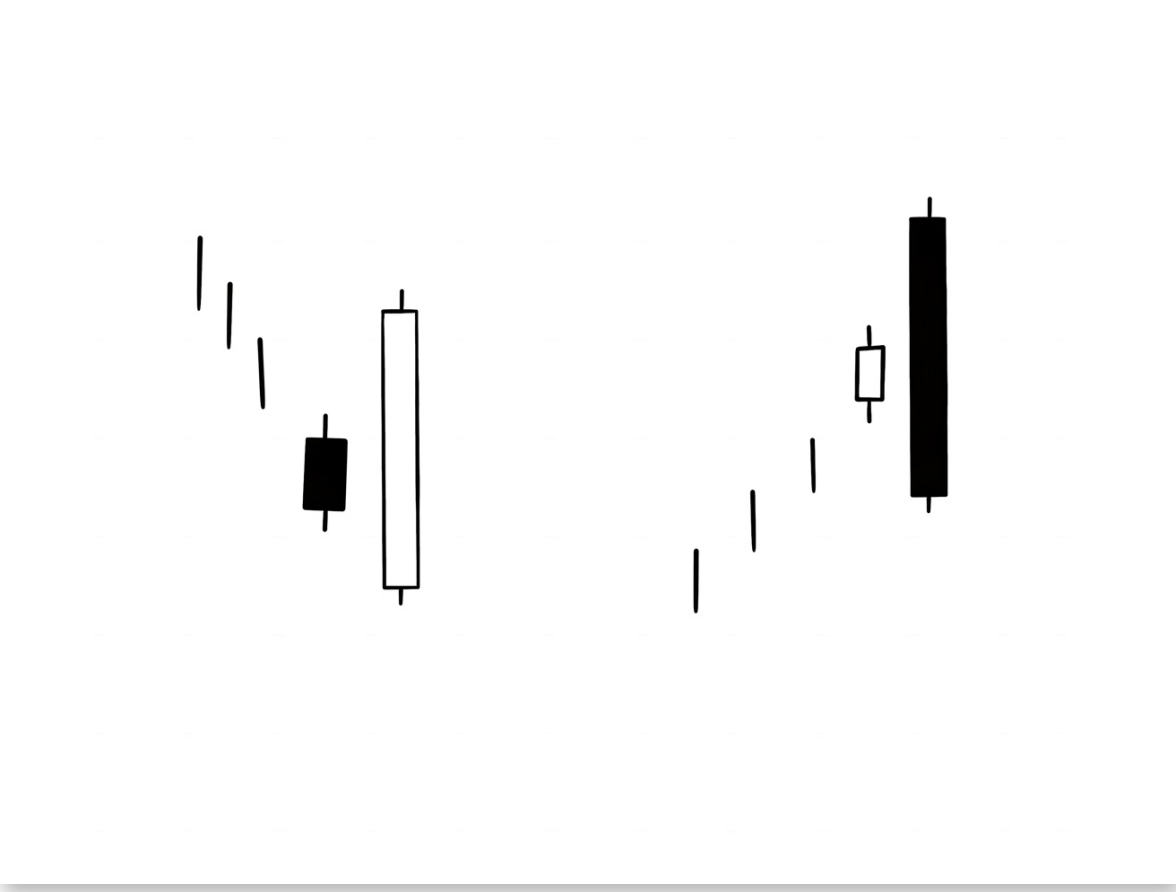


The chart is the USDCAD daily time frame, with each candle representing one trading day. The line of the trend is tested for the first time with two consecutive pin bars. This is a powerful bullish confluence pattern, because the price meets the following conditions.

- Dynamic support given by the rising trend line (for the first time).
- Double bullish pin bars.

Bullish/Bearish Engulfing

The second candlestick pattern is the bullish/ bearish engulfing pattern.



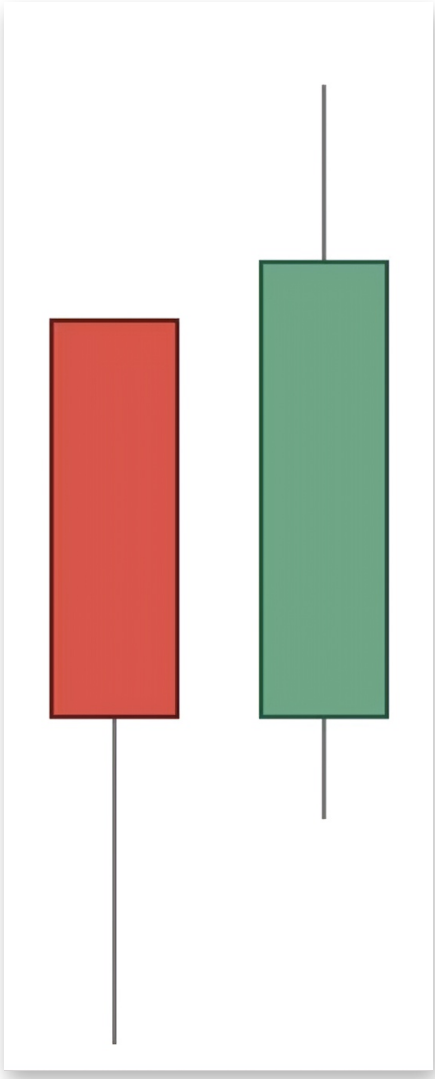
Engulfing patterns consist of two bodies with almost no shadows, with the second body *engulfing* the first. The left-hand example of a bullish engulfing pattern is typically a bullish continuation. The candlestick pattern on the right is a bearish engulfing pattern. It's significant at market tops, where sellers are engulfing the last standing buyers and pushing the price lower.

What about the shadows (tails)?

You may be thinking "What about with the candle wicks/tails? Why are they there? Do we include them in our analysis?"

In a perfect scenario like the one above, a bullish engulfing pattern should include the shadows of the candles. A real bullish engulfing pattern forms when the green body of the second candle fully engulfs the previous candle entirely, including the tails.

There are two schools of thought on this. The first is that the best bullish engulfing pattern forms when both the body and the tails are engulfed. The second school believes that it doesn't really matter if the tails are engulfed or not; the important thing is only the real body of the candle. I ascribe to the second school of thought. It's great if the tails are engulfed, but it's not required.



This is a great example of a bullish engulfing pattern I would consider to be valid. As you can see, the red body of the first candle is fully engulfed by the second green candle.

The lower tail of the red candle is not engulfed by the green candle, but I consider this to be less important. If the read body of

the candle is fully engulfed, I classify it as a bullish engulfing pattern.

Why tails are not as important

Tails may not play a crucial role in validating the bullish engulfing pattern, but they're crucial for a couple of reasons. First, they show the maximum and minimum readiness of market participants to pay for an instrument. That is the highest and lowest value that was reached in a market session. In addition to this, they give us an indication of where to place stop-losses and potential profit targets.

What makes a bullish engulfing pattern meaningful?

A bullish engulfing pattern is a confirmation of what the market participants agree on. When a bullish engulfing pattern forms, market participants agree that price can go higher. More market participants are willing to buy than to sell that instrument at a given time. That is an indication for price action traders that more buyers will join the trend, and that it could trend to new highs.

A bullish engulfing pattern is like a wall of bricks, the more bricks you add to the wall, the more solid it becomes.

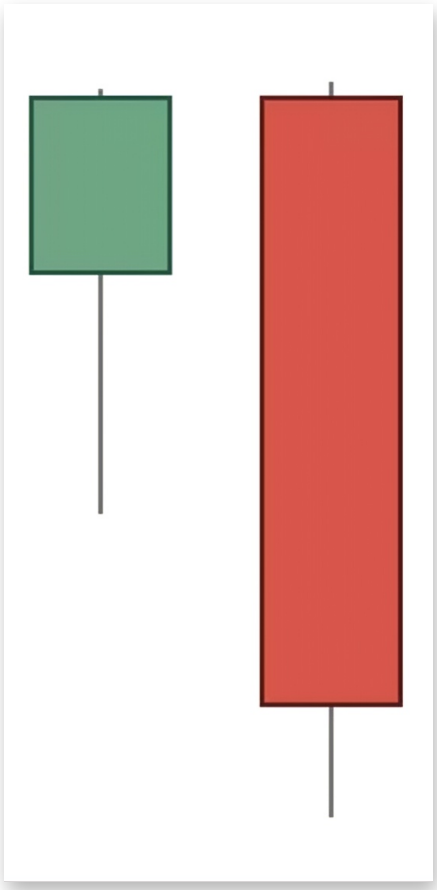
Variations of the bullish engulfing pattern

There are many variations of the bullish engulfing pattern, and it's important to learn to read them. If there is a red body and then a series of green-bodied candles, there could still be a bullish engulfing pattern. What's important is if the green bodies are engulfing the red body of the previous candle.

It's not important how many candles are forming a bullish engulfing candlestick pattern. What matters is that the body of the red candle is fully engulfed by them.

Bearish engulfing pattern

The bearish engulfing pattern is the exact opposite of the bullish engulfing pattern. By definition, a bearish engulfing candlestick pattern is a small green (or bullish) candle followed by a larger red (bearish) candle engulfing the small green candle.

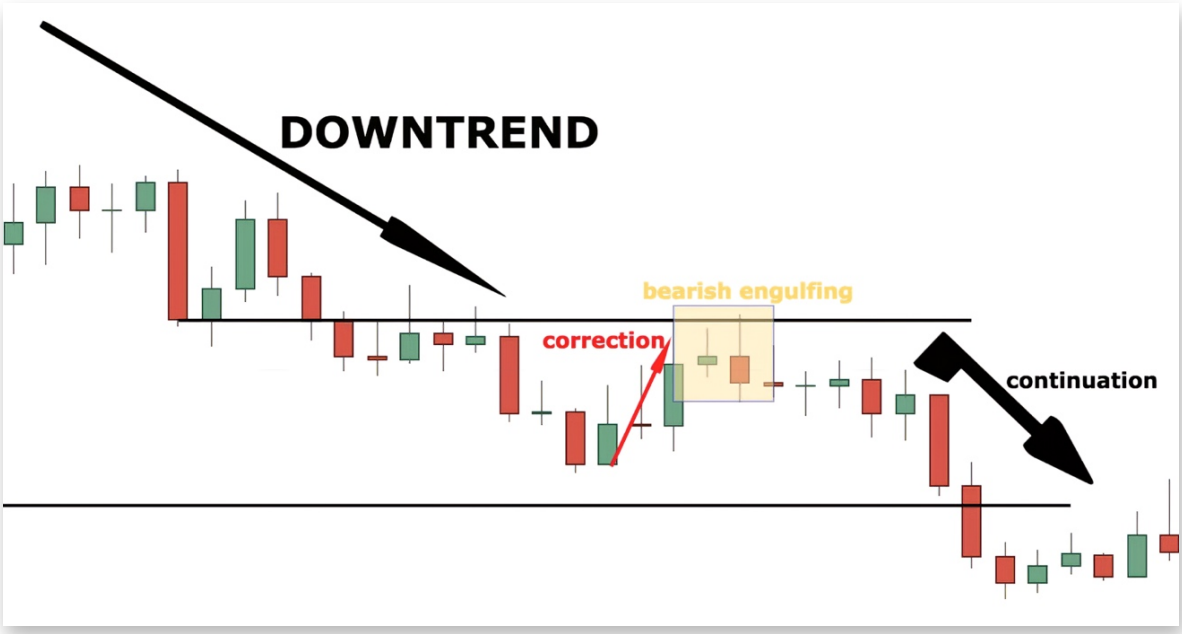


This is a perfect example of a green candle that is fully engulfed by a red (bearish) candle forming a bearish engulfing candlestick pattern. This is one type of bearish engulfing pattern, but there are many variations of the engulfing pattern.

Like the bullish engulfing, the bearish engulfing pattern is based on pure price action. What matters is that there are more sellers than buyers. Bearish engulfing candlestick patterns are strong continuation patterns in downtrends.

Trying to use a bearish engulfing candlestick pattern as a reversal market indicator is not effective. The power of this pattern is in following the trend. They are most powerful when the market takes

a break, makes a bullish correction, and then forms a bearish engulfing pattern. That is usually the best place for this pattern to form.

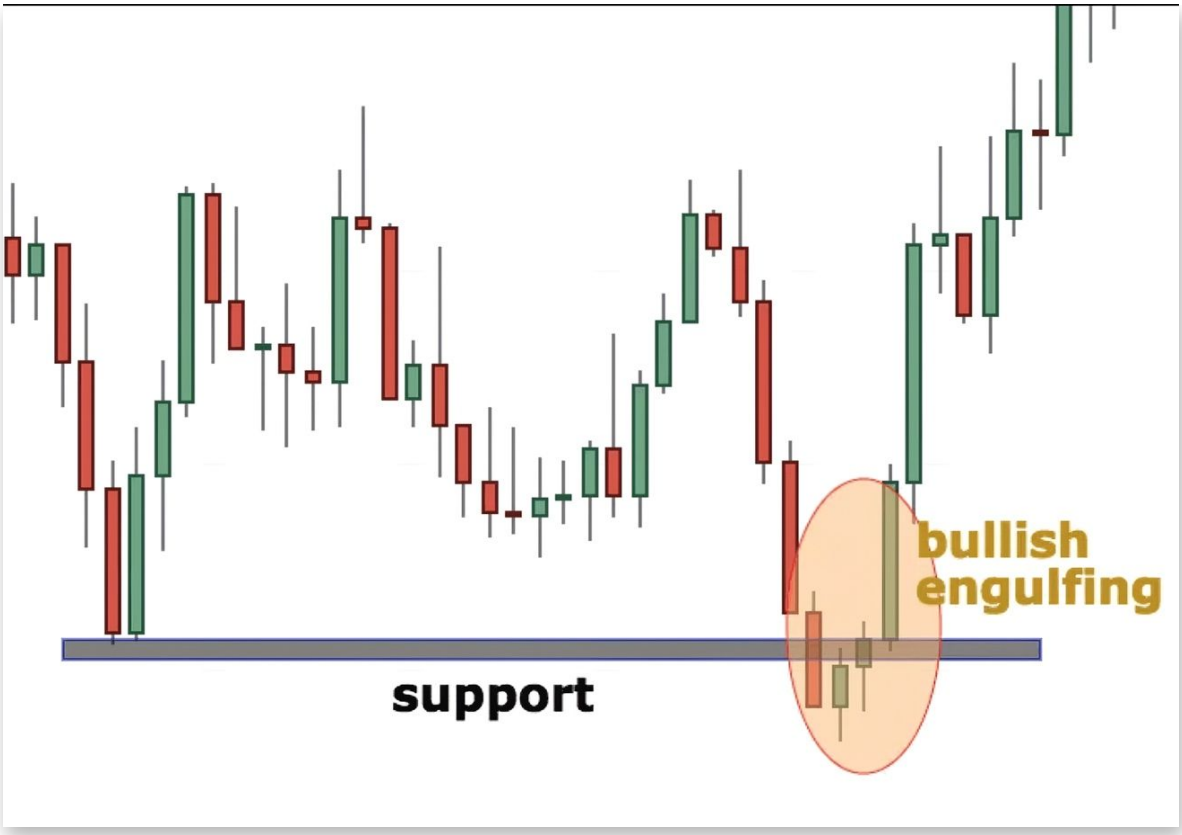


This example illustrates how in a downtrend the price makes a small correction, then forms a bearish engulfing pattern, followed by the continuation of the trend.

Here are some bullish and bearish candlesticks used in conjunction with other trading tools.

Support and resistance

There are many tools that could be used in conjunction with candlestick patterns, but the most important one is the concept of support and resistance.



In this example, the red candle is followed by three consecutive green (bullish) candles, which occurred on top of a major support area. This gives confidence to market participants and pushes the price higher rapidly. After the bullish engulfing pattern is formed, the next candle is long and marks the bullish bias of the market.



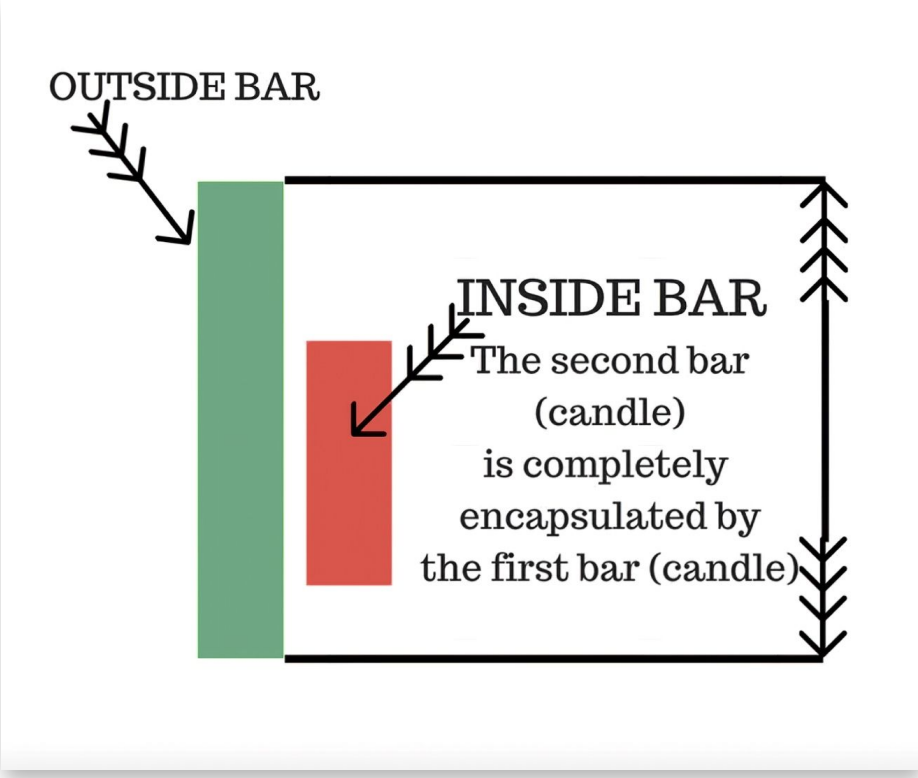
In this example, you can see the opposite scenario play out. There is a resistance area and a bearish engulfing pattern forms. There are only two candles that comprise the bearish engulfing candlestick pattern, but what matters is not the number of candles, but the ability of the bears to *engulf* the bulls, thus showing market participants the readiness of sellers to go short.

Here are some of the other technical tools that are used in conjunction with candlestick patterns and the bullish engulfing and bearish engulfing patterns.

- Moving averages

- Fibonacci levels
- Chart patterns
- Indicators such as RSI, MACD, Stochastic, etc.

Inside Bar



An inside bar is the opposite of a bullish/bearish engulfing pattern. The first candle completely engulfs the second candle, and depending on where it forms, it could either be a continuation or a reversal pattern. That's why it's important to understand the power of this candlestick pattern, as it could assist in finding quality trading entries.

There are many variations of the inside bar, and although the formation comes in different shapes and sizes, the first candle must engulf the second candle. Here are a few variations to study.

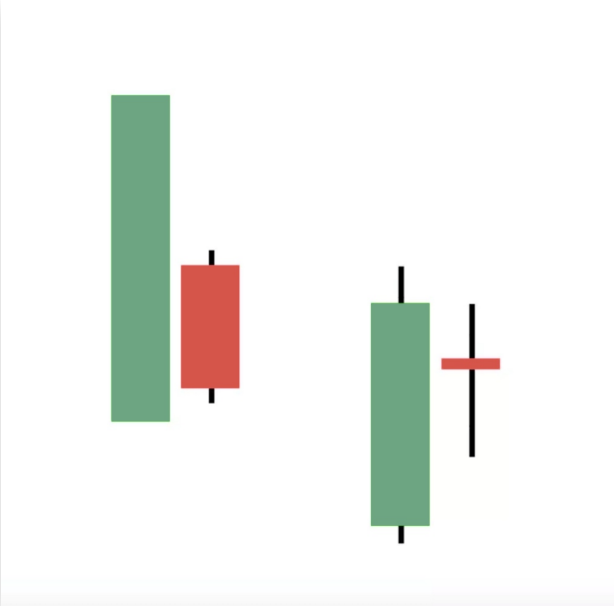
Variation 1



Variation 2



Variation 3



These candlestick formations look different, but the thing that unifies them is that the first candle always fully engulfs the second candle. This rule will help you distinguish the inside bar formation on charts.

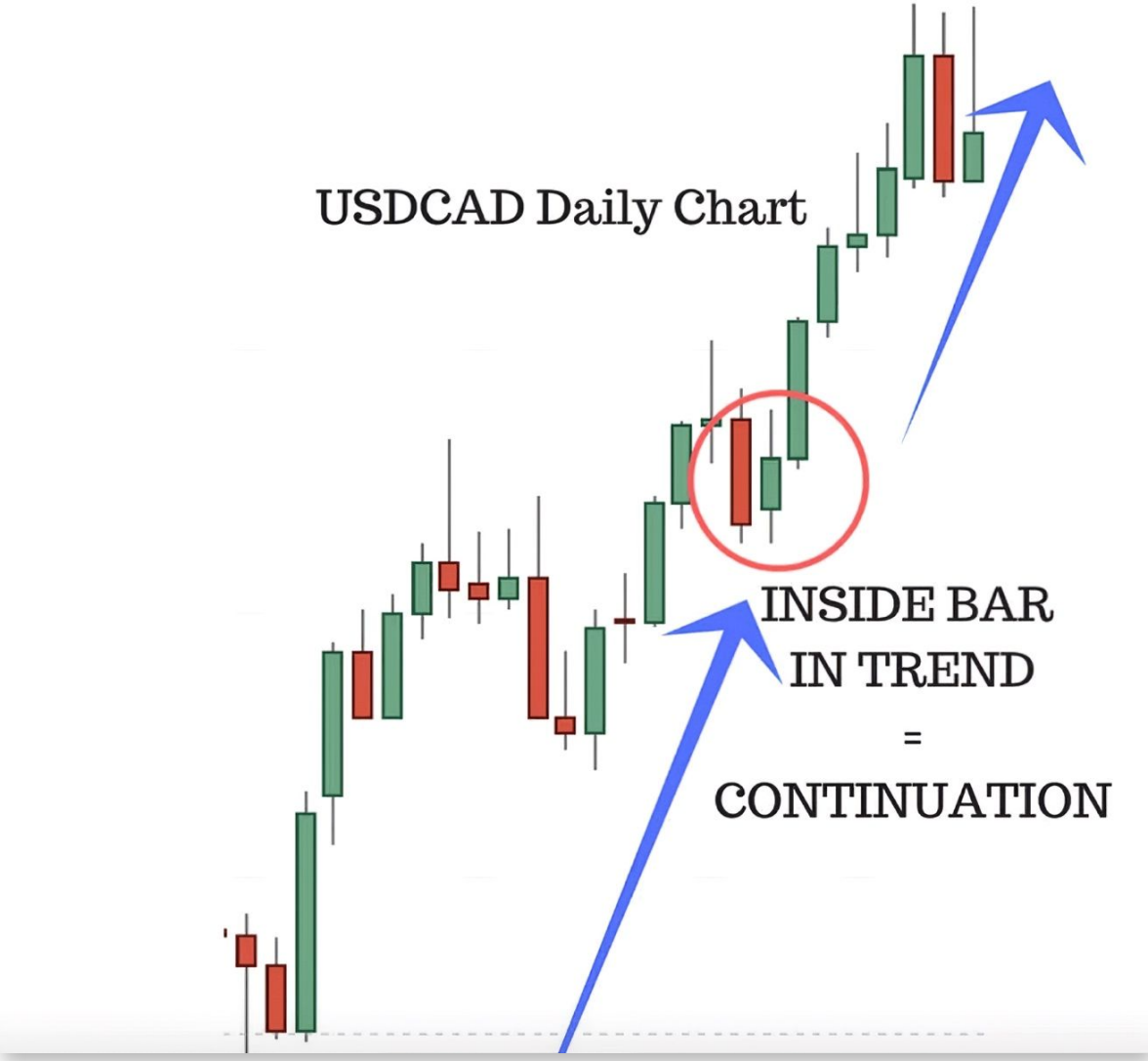
All of these variations are confirming that price is congesting as they gain attention and attract more buyers/sellers, depending on the circumstances.

The inside bar as a continuation pattern

In order to qualify an inside bar as a continuation pattern, the following conditions should be met.

- A well-established bullish or bearish trend.
- No major support/resistance levels near the pattern.

Once those two criteria are met and an inside bar forms, this signals a good entry point for a potential trade. Here are a few continuation patterns of an inside bar within an established trend.



Above is the USDCAD FX pair and the candlestick formation in the middle of the trading range. In this case, you would do the following.

- Wait for a daily close.
- Check if the high and the low of the second candle are within the range of the first candle.

Most inside bar traders would take a long position at the open of the next trading day when these conditions are met.

Here is another example of a continuation pattern and how to trade an inside bar on the DAX daily chart.



There were three occasions on which an inside bar formed, and any of these would have worked well if a long position was taken, and if the above conditions were met.

The inside bar as a reversal pattern

Inside bar trading is not easy, and many traders struggle implementing this strategy. Here are the rules I use for using the inside bar when it comes to reversals. Study the provided charts and start developing your own process.



For an inside bar to be considered as a reversal pattern, there should be an inside bar form around a major support or resistance area. As this chart illustrates, the inside bar formed at a major resistance level on the daily chart. At that point, the candle price quickly reversed and started falling sharply. This pattern occurred on the 2nd of February 2018, when the daily top of EURUSD occurred.



In this example, an inside bar formed on a major support level. The inside bar was then followed by a bullish engulfing pattern, and the price quickly trended higher.

Inside bar trading is as good as trading any other candlestick pattern formation and can be used as part of a trading system. However, you need to consider a few factors in order to take a trade. Using price action isn't difficult, but you must look at different time frames for confirmation, and analyze the overall market environment.

There is no shortcut in trading. You must do the work, follow your trading rules, and create good risk/reward ratios on entry with stop losses and potential profit targets.

Inside Bar Trading- Continuation vs. Reversal

Reversal- There is a reversal of price when it reaches a major support or resistance level and an inside bar forms at those levels.

Continuation- The inside bar is confirming the continuation bias when a well-established trend and price forms an inside bar in the middle of the range.

You will come to appreciate the power of using inside bars for trading trends and trading the range. It is likely one of the least talked about candlestick patterns, and probably one of the most powerful.

There are more complex formations of inside bars like the bullish and bearish hikkake. Please visit my site to gain more in-depth information about these advanced formations.

5

USING TECHNICAL INDICATORS TO TRADE PRICE ACTION

Even if you don't use trading indicators, it's crucial that you understand how other market participants are reading and using indicators so you can comprehend the overall market environment.

When I started trading, I was fascinated by the magic of trading indicators. Momentum was the first indicator I studied, but RSI was the one that hooked me on trading. I wasn't using any price action tools, instead I was trading based on signals given by an indicator.

The best way to learn successful trading is to try many different approaches until you find a profitable system that works for you. Once you find it, make sure that you stick to it and don't look elsewhere; the most successful traders focus on one trading style.

Now we'll take a look at some of the best-known indicators, including the one I started with, RSI.

Relative Strength Index (RSI)

RSI was featured in J. Welles Wilder's book *New Concepts in Technical Trading Systems* and it's still widely used almost 40 years later. The RSI is, just like the MACD or Stochastic, a momentum oscillator and requires additional confirmation before going long or short.

What is the RSI?

The Relative Strength Index (RSI) represents the size of recent gains and losses during a specified time period, and measures the speed of these price movements. It's primarily used to identify potential overbought and oversold situations for a currency pair.

Wilder recommends using a 14-day period as the standard setting for the RSI. The RSI has a higher value when the average gains for the specified period are larger than the average losses. On the other hand, when average losses are larger than average gains during the period, the RSI value moves down. The following chart shows the RSI indicator on the EUR/USD currency pair (blue), notice how the value of the RSI is normalized between 0 and 100.



The RSI can also be used on other time frames than the daily, but it's important to remember that a shorter time period creates a more volatile RSI, while a longer period creates an RSI less sensitive to price changes.

The indicator is calculated the following way:

- **RSI = 100 – [100/(1+RS)]**
- **RS** = Smoothed Average Gain / Smoothed Average Loss
- **Average Gain** = Sum of gains for the specified period
- **Average Loss** = Sum of losses over the specified period
- To create a Smoothed Average Gain, the following calculation is performed:
- **Smoothed Average Gain** = [(previous Average Gain) x 13 + current Gain]
- **Smoothed Average Loss** = [(previous Average Loss) x 13 + current Loss]

Wilder normalized the RSI with this formula to have a range value from 0 to 100. If over the specified period, each session was a gain, then the RSI would have a value of 100. If each session were a loss, the RSI would have a value of 0.

How to use RSI

The RSI is a multi-purpose indicator, and the most popular uses of RSI are included below.

- Identifying overbought/oversold areas.
- Trading the RSI divergence.

Overbought and oversold areas

RSI is widely used to identify when a currency pair (or another financial instrument) is overbought or oversold. The typical values used for this are 30, which indicates an oversold area, and 70, which indicates an overbought area.

If the price moved upwards strong in the recent periods, the RSI will react with a higher value. The presumption behind this is that a quick jump in price is usually not sustainable and will eventually result in a correction downward. Therefore, if the value of the RSI is

70 or more, it’s considered an overbought area and traders should expect a drop in the price.

Similarly, a quick drop in the price will move the value of the RSI lower into the area of oversold conditions. In this case, if the RSI shows 30 or lower, traders should be prepared for a possible correction move to the upside.

As the RSI is a momentum indicator, it can also produce fake signals**.** Therefore, an additional confirmation regarding the direction change should be utilized. One of the popular ways of opening positions in case of overbought and oversold areas, is to let the RSI go above 70, and then wait for the value to break below 70 again to open a short position. In case of oversold areas, wait for the indicator to go below 30 and then to break above 30 again for a buy signal. This is required because the RSI can remain in overbought and oversold areas for long periods if the currency pair is forming a new uptrend or downtrend.



RSI 14

Another popular way of using RSI is when it forms a divergence with the price. This is beyond the scope of this book, but if you would like to learn more about divergences, you can visit colibritrader.com.

The MACD

(M)oving (A)verage (C)onvergence (D)ivergence, or simply MACD can be split into two separate events.

- In the 1970's, Gerald Appel created the MACD line.
- In 1986, Thomas Aspray added the histogram feature to Appel's MACD.

Aspray's contribution served to anticipate (and therefore cut down on lag) possible MACD crossovers, which are a fundamental part of the indicator.

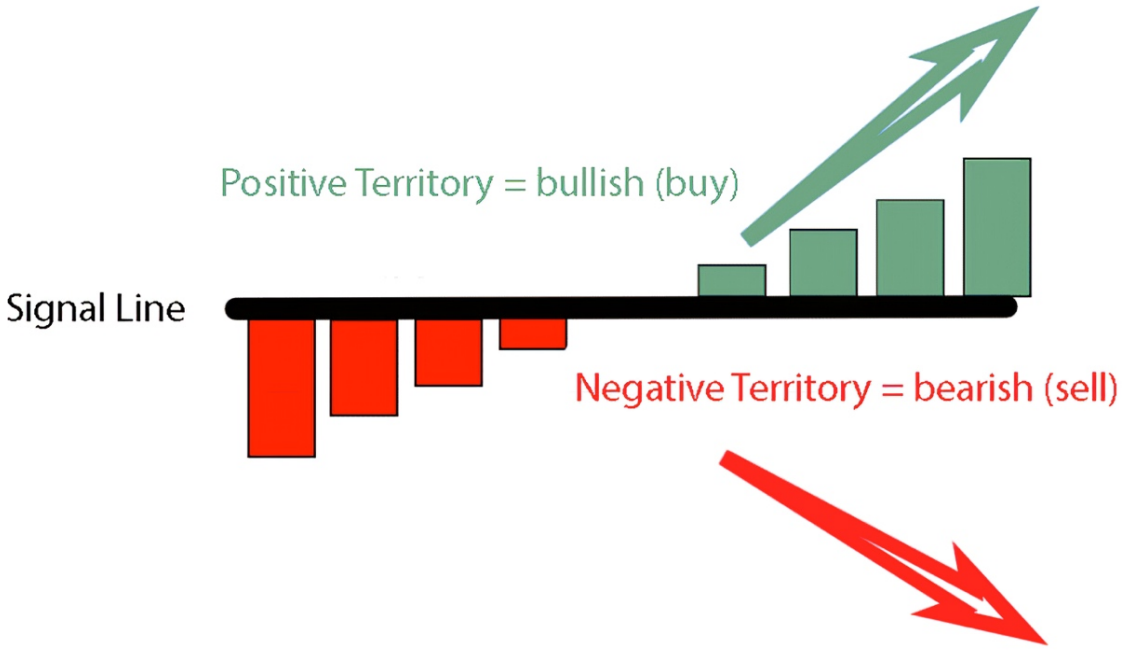
Moving average convergence divergence (MACD) is a trend-following momentum indicator that shows the relationship between two moving averages of price. It's used to spot a change in the short-term trend of the market.

Interpretation of the MACD

There are three common methods used to interpret the MACD



Crossovers – When the MACD falls below the signal line it's a bearish signal, which indicates that it may be time to sell. Conversely, when the MACD rises above the signal line, the indicator gives a bullish signal, which suggests that the price of the asset is likely to experience upward momentum. Many traders wait for a confirmed cross above the signal line before entering a position. They do this in order to avoid getting faked out or entering a position too early.



Divergence – Divergence occurs when the security price diverges from the MACD. It signals the end of the current trend.

Dramatic rise – When the MACD rises dramatically, when the shorter moving average pulls away from the longer-term moving average, it's a signal that the security is overbought and will soon return to normal levels.

You will typically see three numbers on a MACD chart that are used for its settings.

- The first is the number of periods used to calculate the faster moving average.
- The second is the number of periods used in the slower moving average.
- And the third is the number of bars used to calculate the moving average of the difference between the faster and slower moving averages.

The default settings for the MACD indicator are:

- Slow moving average- 26 days.
- Fast moving average- 12 days.
- Signal line- 9 day moving average of the difference between fast and slow.
- All moving averages are exponential.

Calculation of MACD Formula

The MACD indicator is calculated as the difference between the fast and slow moving averages:

MACD=26 Day exponential moving average- 12 Day exponential moving average

The signal line is calculated as a 9-day exponential moving average of MACD.

When not to use MACD

MACD is a simple and popular tool used to identify short-term price trends. However, in a dull and lackluster market, avoid the MACD indicator because it will generate a lot of whipsaws. However, among all the secondary oscillators, the MACD is one of the best and most reliable indicators to identify a trend. It can be especially useful to swing traders.

Remember that there isn't a single indicator that can be used on its own to generate a trading signal. Indicators can sometimes conflict with each other, making it difficult to interpret market direction. Traders should strive to stick to what already works for them, rather than adding too many indicators and complicating their trading plan. Technical indicators are tools for filtering price action and each serves a specific purpose when trading.

ATR

ATR is one of the less used and more complicated indicators. Here are a few major points regarding the ATR indicator:

- Originally developed by J. Welles Wilder, in his book *New Concepts in Technical Trading Systems*.
- Potential of confirming reversals.
- Calculation of ATR Indicator.
- Used for risk calculation and position sizing.

Originally developed for stocks and commodities, this indicator can easily be adapted to the Forex market. The ATR indicator provides an indication of price volatility in absolute terms, as Wilder was not interested in price direction for this indicator. Wilder recommends using a 14-period ATR on a daily time frame. A currency pair which has larger movements and higher volatility will also have a higher value for its ATR reading.

A currency pair that is trading sideways will have a lower ATR reading. These values are of interest to traders because they can quickly gauge the price volatility and make better decisions about position sizing and stop losses.

The ATR can be used as a confirmation for bullish or bearish reversals. An increasing ATR value at the beginning of a possible reversal might be used as a confirmation signal because it shows growing momentum of long or short positions.

The Average True Range calculation is based on the N-day moving average of the true range values for a given currency pair, or

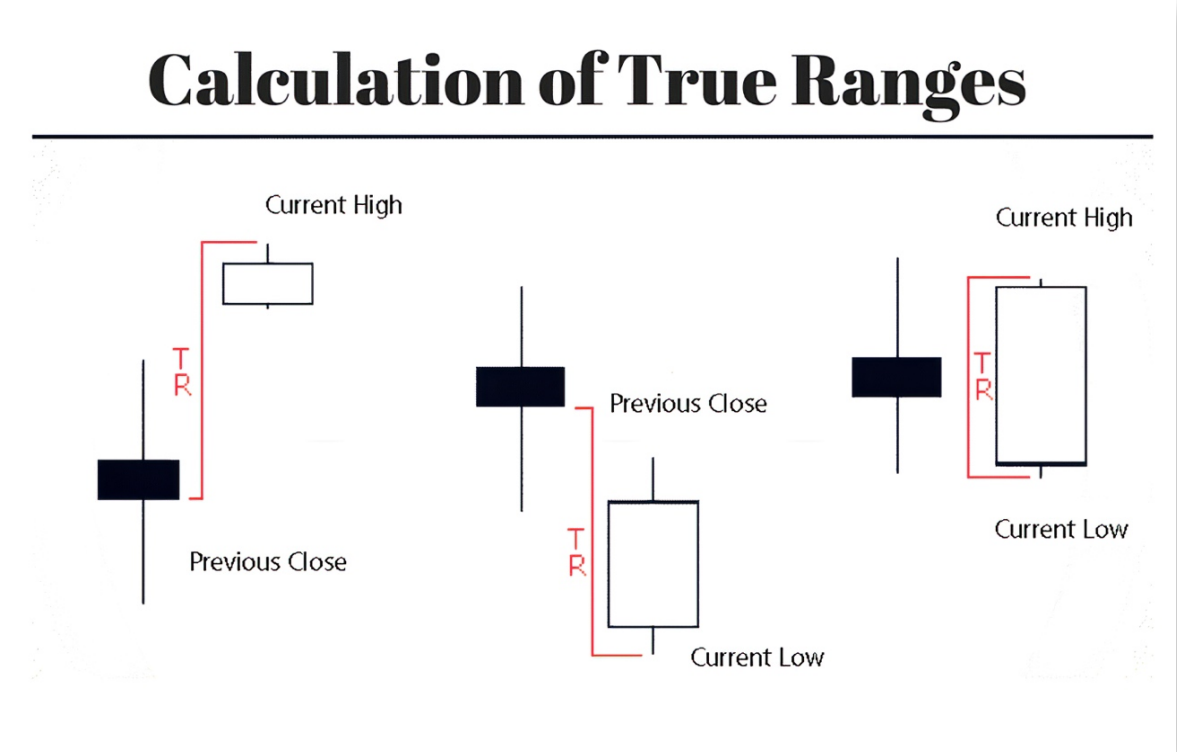
another financial instrument.

The True Range is a concept Wilders described as the highest value of the following:

- The current high minus the current low.
- The absolute value of the current high minus the previous close.
- The absolute value of the current low minus the previous close.

This concept is introduced because Wilders was interested in the price volatility of commodities during the development of the ATR indicator. As the trading volume on commodities is usually low and price gaps often occur, simple volatility calculations based on the current highs and lows didn't give adequate results. Instead, using True Ranges for volatility calculations, which consider gaps from previous sessions, give much better results.

For example, if the current high is above the previous close, and the current low is equal or below the previous close, then the current high minus the low will be used as the true range value, that is method (a). On the other hand, if the current session opened with a gap or the current session is an inside bar, then methods (b) or (c) will be used, whichever is larger.



The first price pattern shows a gap from the previous close, and method (b) will be used for the True Range calculation. The second price pattern shows a gap to the downside, and therefore method (c) will be used. The third price pattern shows an engulfing candlestick, with highs and lows outside the previous bar. Method (a) calculates the True Range in this case.

Again, the recommended period for the ATR indicator is 14 days, so the value of the ATR will be the moving average of the 14 previous days. Based on this, the ATR is calculated using the following formula:

$$ATR_t = \frac{ATR_{t-1} \times (n-1) + TR_t}{n}$$

The current ATR value is equal to the previous ATR value multiplied with period-1, and added to the current True Range value. The result is then divided by the current period.

As we need a beginning value for the ATR, the ATR for the first 14 periods (assuming our ATR period is 14 days) is the average of the sums of True Ranges for the first 14 periods. The ATR formula shown is used on the beginning of period 15.

What is ATR used for?

ATR is widely used for position trading. A currency pair (or other financial instrument) with a higher volatility and higher ATR will require a larger stop-loss level than a currency pair with a lower ATR. The usual stop-loss level determined by this strategy is the current ATR level. Putting a stop-loss that is too large on a currency pair that has a low ATR would create unnecessary risk for the trader. The opposite applies to currency pairs with high ATR readings. In this case, the used stop-loss and take-profit levels should also be wider, as the position is at risk to be closed early due to price volatility. In general, the greater the ATR for a currency pair the wider the stop-loss level should be.

Because ATR uses True Range for its calculation**,** which is in turn based on absolute price changes, ATR reflects the volatility of a price, not in percentage terms, but in absolute price levels. Therefore, a currency pair that usually has a high exchange rate (like GBP/JPY for example), will also have a higher ATR than a currency pair, which trades on a lower exchange rate. This makes ATR comparisons between different currency pairs nearly impossible.

Stochastic

> “Stochastic measures the momentum of price. If you visualize a rocket going up in the air – before it can turn down, it must slow down. Momentum always changes direction before price.” – George Lane

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Stochastic is an oscillator that is a momentum indicator that compares the closing price of a security to the range of its prices over a specific time period. Observing nature through the lens of

probability theory is what mathematicians call the *stochastic view*. The word comes from the Greek *stochastes,* a diviner. It in turn comes from *stokhos,* a pointed stake used as a target by archers.

The Stochastic Formula

$$\%K = 100(C - L14)/(H14 - L14)$$

- **C**=the most recent closing price
- **L14**=the low of the 14 previous trading sessions
- **H14**=the highest price traded during the same 14-day period
- **%K**=the current market rate for the currency pair (a.k.a. Fast %K)
- **%D**=3-period moving average of %K (a.k.a. Slow %D)

When the market is in an uptrend, the prices are close to the high and when the market is in a downtrend, the prices are close to the low.

Stochastic measures the speed or rate of acceleration of a security. In extremely fast markets, the Stochastic's angle is sharper. When the price slows down, the indicator is reflecting that change and is steepening out. The default settings of the stochastic are 14 and 5 periods. These readings are the absolute high/low for that period compared to the closing price. Other commonly used parameters for "K" are fifteen, ten, or five days.

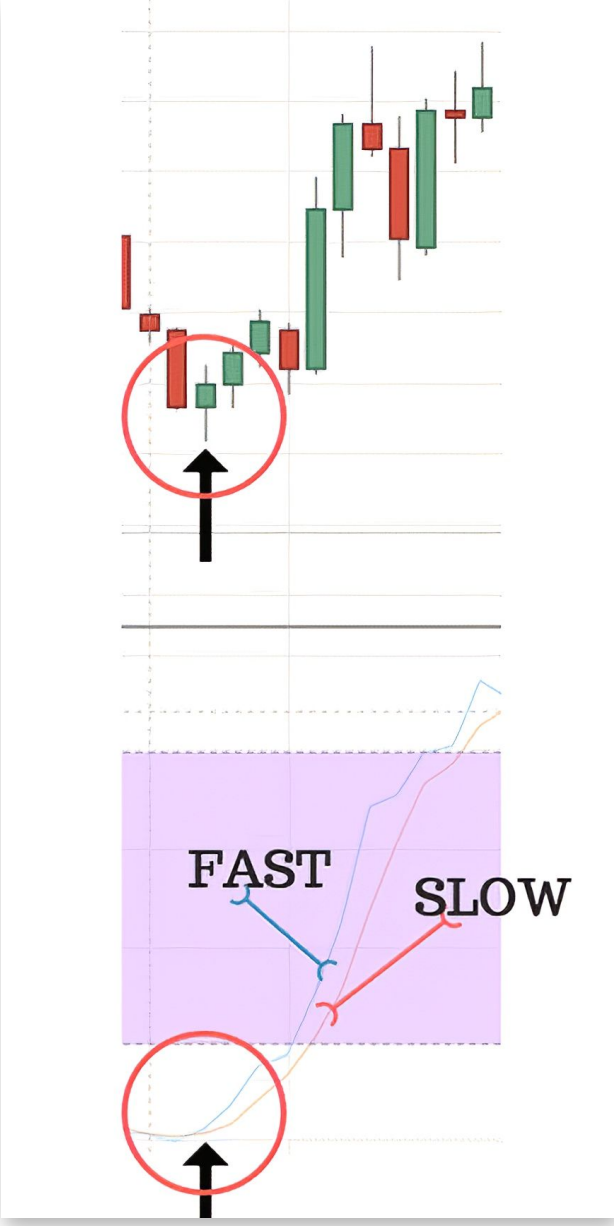
As prices move down, the close of the day tends to crowd the lower portion of the daily range. Just before the absolute price low, the market has less push than it did in the early stages. This means that Stochastic turns up at or before the final price low.

This shouldn’t be considered a Holy Grail in trading, because traders need to look for a combination of indicators or a confluence of factors before executing a trade. No matter how tempting and simple it sounds to use a single indicator, you should be aware of the dangers inherent in daily market volatility.

Applications of the Stochastic indicator

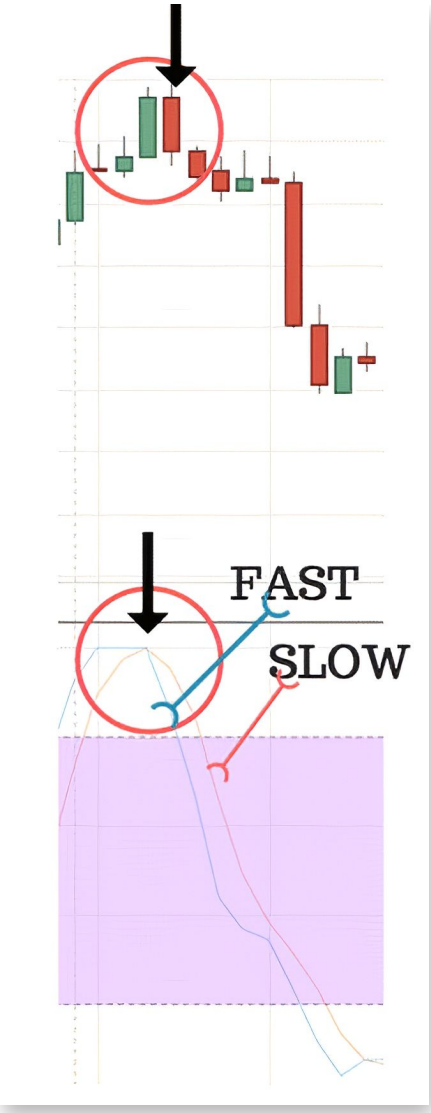
Bullish Signal

If the Fast K line pierces the slow line from south to north (on the left) it’s a bullish signal and market participants will be buying.



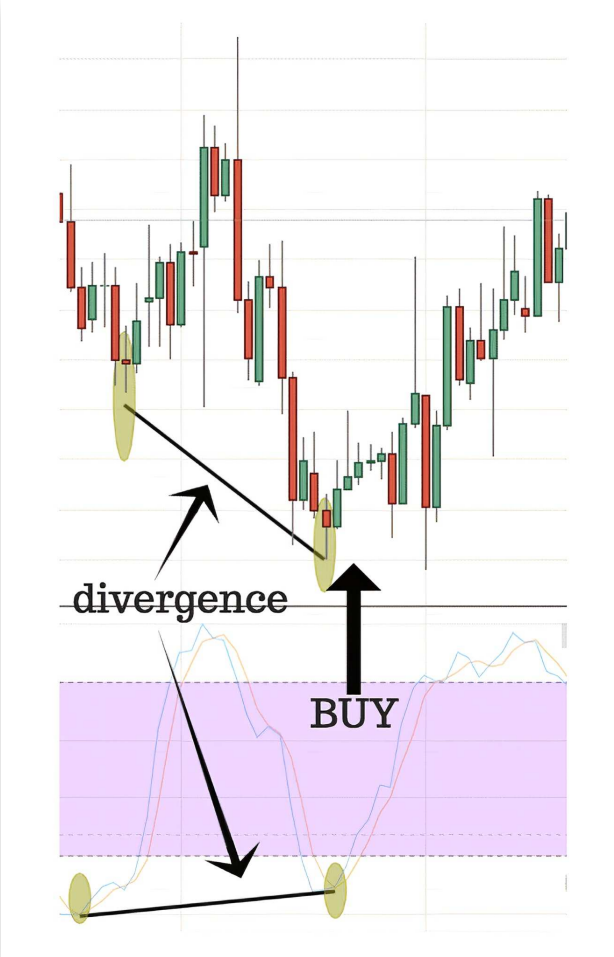
Bearish Signal

If the Fast line pierces the slow line from north to south (on the right) it's a bearish signal and market participants are selling.



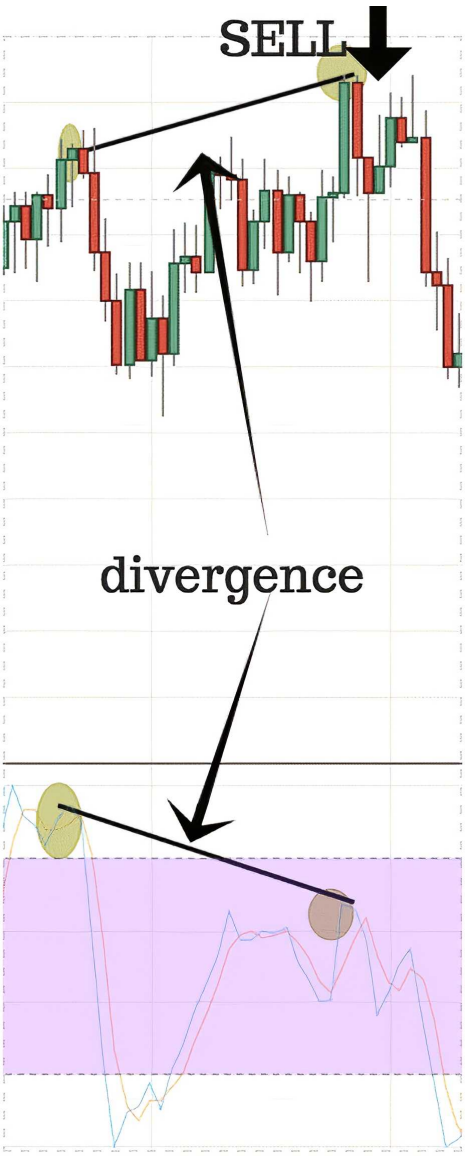
Positive Divergence

Market participants look for a positive divergence when they're buying. The divergence principles with Stochastic are the same as any other oscillator. Traders are looking for an extreme low level in the oscillator. The price should be making a new low and the oscillator should be forming a higher low than the previous one.



Negative Divergence

Stochastic gives a signal to sell when there is a negative divergence between price and the indicator. Traders are looking for an extreme reading in the indicator. There should be a higher high in the price chart corresponding to a lower, second high on the indicator for traders to sell.



Stochastic versions

There are usually three versions of Stochastic:

- Fast- The fast version is the choppiest.
- Slow- The slow version is a smoothed version of the fast version.
- Full- The full stochastic is a customizable version of the slow stochastic.

*Calculations

Fast

Fast %K=%K basic calculation
Fast %D=3-period SMA of Fast %K

Slow

Slow %K=Fast %K smoothed with 3-period SMA
Slow %D=3-period SMA of Slow %K

Full

Full %K=Fast %K smoothed with X-period SMA
Full %D=X-period SMA of Full %K

6

RANGE TRADING VS. TREND TRADING

One of the biggest challenges in trading is how to determine if the market is in a trend or if it's in a range. Unfortunately, this isn't easy. If it were, traders would just apply range trading or trend following strategies that everyone knows.

All of the trend indicators and oscillators offered by a trading platform come with a default interpretation, meaning that even if a trader doesn't know how to use them, a simple Internet search can solve the mystery. However, most it can be difficult for retail traders to apply the standard interpretation on live markets because range trading or trend following strategies are very different.

The key is to define the market first, apply technical trading strategies to that market, and watch for changes in market conditions (reversal patterns or anything that indicates that ranges or trends might end). This is the key to price action trading with trends and ranges, but it's not how most traders operate. Traders typically learn a strategy, apply it on a trading vehicle with some success, and keep trading it on other instruments and other time frames, only to see it fail in different market conditions.

Some markets are in trends while others consolidate, making different trading strategies necessary. In other words, range-trading strategies won't work in trending markets, and trend following strategies won't work in ranging markets.

What makes a trend?

A trend refers to the price action of a market that rises or falls. Either bullish or bearish, trends are the bread and butter of every trader.

A bullish (or rising), trend is a series of new highs and new lows in the market. There is no trend without a pullback, and that's what creates the next essential element in a trend, the higher low or lower high.

Combining the new highs and lows with the pullbacks is the definition of a trend. As such, a bullish trend is a series of higher highs and higher lows, while a bearish trend is just the opposite, a series of lower lows and lower highs. Unless the series breaks, the trend will keep on going. This is a good way to differentiate ranges from trends.

If an uptrend breaks to new lows or a downtrend breaks to new highs, it's the first sign that a trend is ending. This sets up the possibility of the market shifting to a trading range.



This EURUSD price action is a good example of the break lower from the 1.25 area, followed by a sideways range. This is a bearish trend that is followed by a ranging market. Keep in mind that the same principles apply on all currency pairs/instruments and all time frames.

Rules for range trading or trend following

The main difference between a trend and a range is the speed of direction. Trending markets take no prisoners; they keep tripping stops for those positioned on the wrong side of the market.

Most traders want to trade because of market trends. The easiest way to make a profit is to ride a trend for the long-term, but this is difficult because trends aren't that common. In fact, statistics tell us that the financial markets are locked in consolidation most of the time.

In trend following, fast moving markets leave no room for error, and this makes setting proper stop losses a compulsory tool. If the trend holds, most trend-followers focus on trailing the stop and buying the dips. The easiest way to let profits run is to ride the trend until it ends. The end of the trend comes when the market breaks the lower highs series (in a bearish trend) or, the higher lows (in a bullish trend). That's the moment when it's highly probable that a long period of range trading will begin.



Price action in a range can be frustrating. Undisciplined and impatient trend following traders can keep adding to a direction on a market pullback instead of applying range-trading strategies. Their mistake is that they are still biased and this inevitably leads to overtrading and costly mistakes.

Trend following techniques



This chart illustrates a bearish trend. With every candle or group of candles, the market keeps pushing lower, making a series of lower lows, which is a characteristic of a downtrend. More importantly, there are bounces from a series of lower highs. From left to right, both series keep going, and trend-followers should ideally let their profits run.



The key to trend following and range trading is to check for reversal patterns that break the series. These are patterns that have the potential to cause a breakout in the series of a trend. For example, right in the middle of the bearish trend, the EURUSD formed a potential reversal pattern.

A *morning star* is a group of three candles, with the first one forming in the direction of the trend, the second one having a small real body, and the third one moving in the opposite direction.

Remember: Any candlestick reversal pattern has one necessary condition, it remains valid only if the price doesn't break above or below its high or low. Also, it needs to form on a major support or resistance level to be considered valid.

For instance, after bullish candlestick reversal patterns like the hammer, morning star, piercing or engulfing, the price can't break the lows in the pattern. After bearish ones like the shooting star, dark-cloud cover, evening star or bearish engulfing, the price can't break the highs. If it does, price action indicates that the underlying strength of the trend is returning. Traders then go back to the conditions of a trend and add to the main direction. In this case, the pair bounced, but it failed to break the lower highs series, and as it broke the lows, it indicates a great place to add to the underlying trend's direction.

Price action after trend following ends

One of the biggest problems when interpreting price action knowing when market conditions change. The rules of ranging and trending markets remain the same, regardless of the currency pair or time frame. As such, by using a standardized approach, traders stand a better chance of making a profit in the currency market.



After the morning star pattern failed, the market continued to make new lows and the bounces didn't break the lower highs series. When another reversal pattern formed, the head and shoulders took more time to finalize.

Will the market break it?

As it turned out, the price did break the series, bringing the bearish trend to an end.

At this point in the analysis, traders still don't know if range trading or trend following strategies will work better in upcoming trading sessions. The attention then turns to the price action immediately following the bearish trend.

A reversal pattern that holds (meaning the lows aren't broken after a bullish pattern) implies a new trend is starting. Is it possible for the market to form a bullish trend right after a bearish one? Yes, it is possible. Traders look at all the possible clues to see what they'll use next; range trading or trend following strategies. If a new trend starts, the price action must form a series of higher highs and higher lows. That means the low in the head and shoulders pattern must hold.

Another important factor to consider is whether the *turning point* has formed on a major level or whether it's in the middle of a range. In my experience, if a *reversal* formation is not appearing on a major

level, then there may not be a reversal at all. That's why it's important to keep support and resistance levels on charts for reference.

Trading the trend

A popular trading strategy is to wait for price to touch the trend line and trade it. For example, in an uptrend, when the price makes a higher low and touches the lower trend line, traders will buy. The same patterns repeat in a downtrend; once the price makes a lower high, traders will trade the trend line and sell. In a range (no trend), trend followers try not to trade at all.

Trading the range or buying when price touches support and selling when it touches resistance seem like simple trading strategies. However, they can be quite subjective, particularly when drawing a trend line. It can be difficult to decide whether you should connect the lows/highs or the open/close of the candlestick.

I usually look at the extreme points, or the high and low values as opposed to the open/close. In my experience, the highest and lowest values are an indication of what traders are willing to pay in order to hold a security, so I prefer to use these values when drawing trend lines.

Other popular trend trading tools

Fibonacci Levels– Some traders prefer to use Fibonacci levels in order to follow the trend. Once a new high has formed, traders draw the Fibonacci retracements to see where they can re-enter the trade.

Four of the most popular Fibonacci levels are, 23.6%, 38.2%, 50% and 61.8%. These are highly pursued levels, and once these levels are identified, horizontal lines are drawn in order to define levels of support/resistance.



Defining the Trend

Moving Averages- Another popular approach is to look at the markets through the prism of the Moving Averages. Moving Averages are calculated by taking the average value of a financial instrument over a certain amount of time.

Some popular Moving Averages (MA) are 5-day, 8-day, 20-day, 50-day and 200-day. For instance, a 50-day MA is calculated by summing up the past 50 days of closing values and then dividing them by 50.

There are different types of moving averages and the calculations are different. I will skip the mathematical explanations and emphasize how traders use them to follow the trend. I recommend you read more about moving averages at NewTraderU.com.

Moving Averages– One of the easiest ways to define a trend is by using moving averages. A lot of traders use Simple or Exponential Moving Averages. For the sake of this example, we will use an exponential moving average.



How do we decide whether gold is moving up or down or if it's locked in a range?

In the gold example, if the price stays below the moving averages, we have a downtrend. If the price stays above the moving averages, we have an uptrend. If the price dynamically changes from below to above in relation to the moving averages, then there is a range-trading environment.

Based on this definition, trend followers only buy when the price is above the moving averages and only sell when the price drops below the moving averages.

Moving Average Crossover– Another popular trading strategy is to combine two moving averages and look for a crossover. One popular combination of moving averages is the 10-day and 20-day. Trend-followers using moving averages will wait for a crossover to happen before taking a trade. The crossover occurs when the shorter moving average crosses above the longer moving average in an uptrend, and/or the shorter moving average crosses under the longer moving average in a downtrend.

In that moment, many traders will attempt to follow the trend by opening a long/short position depending on the above/below the crossover. (Bullish Crossover is when the shorter-term moving average crosses above the longer-term one. Bearish Crossover is

when the shorter-term moving average crosses below the longer-term moving average). In the example, you can see a bearish crossover with a Moving Average Exponential Ribbon.



Exponential Moving Average Ribbon– Another popular trend-following strategy is a combination of three or more moving averages, also known as a Moving Average Exponential Ribbon. The ribbon is an overlay of multiple moving averages, and just like other moving average strategies, a trader should look for a visible crossover and then take the trade.

This example illustrates a bearish crossover on the EUR/USD pair, which is also where the sell signal occurs. It's important to discern whether the crossover occurs in a trending environment or in a range.

Support and resistance with trends

Many traders, including myself, use support and resistance to decide where to enter a long/short trade. As discussed previously, there are many techniques and ways to use support and resistance. For this section we'll be looking at how support and resistance can be used to trade with the trend.

Trading Channels– Many traders like to use diagonal lines because they find them helpful in analyzing the next move in a particular security. In this example, you can see this diagonal channel in action.



Traders look to buy in an uptrend when the price touches the lower line of the channel. In a downtrend, they sell when price touches the upper line of the trading channel. Many trend followers favor this strategy, but I find it more subjective and that's why I prefer to use only horizontal lines for support and resistance.



Support and Resistance Levels

I typically look for a pullback towards the previous support level (in an uptrend) to initiate my trades with this method. I find this to be much more effective and less subjective.

There are many ways to follow the market. Entire trading schools of thought have been dedicated to this concept. In a book called *The Way of the Turtle,* Curtis Faith explained how two legendary traders taught 23 ordinary people, from all walks of life, how to follow their trend trading system. The author himself was one of the youngest of this group, who made over 30 million trading the system for about four years.

At the end of the day, it is hard to say whether it's easier or more profitable to follow the trend or be a contrarian. Both trend followers and contrarians have found ways to make money. Both styles can come in and out of favor in different market environments. Whatever works for you, stick with and keep working.

Common trend trading mistakes

- **Enter too early**– Traders often enter trades prematurely. They don't have the patience to sit and wait, and this

usually costs them a substantial amount of money. To become a consistently profitable trader, one needs to master trading psychology.

- **Exit too early**– The opposite mistake is exiting a trade too early. Cutting your losses short and letting your winners run for as long as possible is important if you want to be profitable. Many traders consistently swing between the emotions of greed and fear. If they can't accurately exit a trade, it significantly reduces their chance of winning. Once again, patience is important.
- **Don't follow the rules**– A common mistake that traders make is not being able to follow their own rules. Your trading rules should be written down and in front of you when trading. This can be challenging, so if you struggle with following your rules, check out disciplinify.me, a trading app I developed to make this process easier.
- **Fear pulling the trigger**– Another common mistake that trend followers make is the fear to place a trade. That's not only a beginner's fear, but also every experienced trader's nightmare after a losing streak. A good solution for that could be staying away from the markets for a while, or trading on a demo account until you regain confidence.
- **Not keeping a trading plan**– Keeping a trading plan is one of the most important habits of the profitable trader. If you aren't sure how to make your own trading plan, please check out Disciplinify.me.
- **Have a rigid money management agenda**– Some people say that money management is the hardest aspect of trading. It seems easy to the newcomer, but it becomes more difficult when trading with a larger size. If you don't have the right money management methodology, you could panic and make critical mistakes.

Should you avoid the range?

In the end, why is it so scary to trade the range? Isn't the market range-trading 80% of the time? Should you only trade the market

when it’s in a trending environment? Shouldn’t you be more flexible and try to take advantage of both market conditions?

These are probably some of the most quintessential questions that traders ask themselves. The important thing for you to focus on is that your equity curve is consistently rising.

Most people have a desire to be right and feed their ego, and this is probably what motivates some traders to constantly search for a Holy Grail strategy that works in all market conditions. This isn’t possible and isn’t what trading should be about. As boring as it sounds, you should only be focused on growing your profits and following your trading plan.

Most of the successful traders I know went through years of losing or breaking even. Trading is a serious discipline; make sure that it’s what you want to do before you start to trade.

7

MISCONCEPTIONS

The power of price action

I have often asked myself why it's so difficult to effectively learn and practice price action trading. Although it takes a great deal of study, I believe price action is the tool that has made me consistently profitable. Combined with risk management and trading discipline, price action gives traders an edge that's hard to beat.

Misconception # 1- Price action is simple

The biggest misconception about price action is that, unlike other methods, price action is a simple trading approach. Trading price action is easy to learn but challenging to master. The difficult part of price action trading begins when resistance occurs.

Although it looks like it's limited in its scope, price action is limitless. There are as many variables as there are possible outcomes. What makes a price action trader great is their ability to be honest with themselves and keep an open mind. That's why it can be so easy to fall into the trap of price action trading subjectivity.

It takes, time, persistence, the right trading approach, discipline, capital, learning from your mistakes, and more time before you can become a profitable trader. Be prepared for more downs than ups in the beginning of your journey.

Remember: There is nothing more complicated than mastering a simple trading system!

Misconception # 2- A mentor is necessary

This isn't necessarily the case, but you need to realize that without guidance, it could take twice as long, or more, to learn the basics and become profitable. A mentor can save you time and money by limiting costly mistakes, and they can be a good resource in addition to trading courses. The truth is that you shouldn't expect to be successful without putting in the long hours and practice necessary to be profitable, whether you choose to study with a mentor or not.

Misconception #3- Price action is the best method

Price action is the best method *for me* because it fits my personality, and it's the one that has proven to be consistently profitable. But what's right for me may not be a perfect fit for you. You can choose any trading style, if your profits and losses prove you right. No trading style is superior to another. If someone tries to convince you that you should trade only one way, they're trying to sell you something or they haven't been around long enough. Trading is more than just a trading style, it's mostly about you.

Misconception #4- Price action is just about price

Price action trading isn't just about price, there are many other factors that come into play. One of the most important elements, maybe even more important than price itself, is the concept of support and resistance.

The concept of support and resistance is not simple. Knowing how to correctly place support and resistance levels is more art than science. Knowing how to use those levels profitably is more about experience than judgement.

Other elements like Candlestick charts, or even Renko charts are also part of the equation.

Misconception #5- You can copy someone else's trading strategy

That's not a good idea. Although such an approach might be profitable for a while, there are many reasons why this strategy won't be successful in the long-term. Imagine you're in a winning streak because the trader you're following is in a winning streak. Suddenly, they start to lose money. You panic and make one or all of the following mistakes:

- Increase your trading size.
- Change your signal provider.
- Start trading on your own.

Even if the trader you're following is good at what they do, it doesn't necessarily mean that you will make money consistently. There are many things that can go wrong, and you'd be better off asking them to mentor you so you learn the *why* as well as the *how*. Even then, there's no guarantee that you won't make some costly mistakes along the way.

Eventually, you will be relying on your own knowledge and judgement and there won't be anyone else to blame or anywhere to hide. The moment you're able to take full responsibility for your trading success or failure is the moment that your journey into professional trading begins.

Misconception #6- Price action trading is good on all time frames

As a trader who has tried all time frames, from one minute to monthly, I think the best times for using price action are daily and hourly. You may be wondering if being patient on the shorter time frames would make this a viable strategy, and while it's possible, my

experience and interactions with other traders lead to me believe that those are the best time frames for price action. In the end, you should experiment and tweak until you reach your own perfect combination.

Misconception # 7- You can predict the markets

Traders are often willing to take a trade before a candlestick has formed. For example, you're waiting for a daily candle to close, but at 2pm you decide that a pin bar will form. Unfortunately, a few hours later you find out that the daily candle is a long-legged doji. At that point it's too late because your stop-loss is taken.

Patience is important. You can't expect the market to move in a particular direction. Successful traders are always reading the market, but they don't expect anything or make predictions. If a pattern appears, they will act on it. If the pattern doesn't show up as expected they'll wait until the right one does.

8

FINAL THOUGHTS

If you find yourself in a losing position you have two options, panic and do nothing and let the price run against you or follow your predetermined rules and most likely cut the position.

Most inexperienced traders will go with the first option, while the professional traders instinctively choose the second option. Experience is what makes a profitable trader and it takes time to reach a professional level in trading.

You will make mistakes and learn from them, and if you dedicate yourself to the learning curve and are willing to put in the long ours required, you can become a professional, profitable trader. If you don't have the time or ability to commit to becoming an experienced trader, you may find that being a hobby trader is best for you.

In the end, what determines your success won't be external circumstances or market environments. Your ability to become and remain profitable over the long-term will be based on your ability to understand yourself, your limitations and your strengths. Understanding yourself and knowing how to control your emotions will give you a substantial edge over other market participants.

Trading Tools I Use:

Trading Psychology and Discipline- Disciplinify.me
Free Charting Software- Tradingview.com
Best Free Stocks Screener- Finviz.com

ABOUT THE AUTHOR

Atanas Matov a.k.a. Colibri Trader (@priceinaction on Twitter) started his trading career as a retail trader in the early 2000's. After a few years of trading and investing his own funds, he won the KBC stock market challenge and shortly afterwards started working for a leading prop trading house in London. Currently he is trading his own account and trying to help other traders through his trading blog and social media. Major part of Atanas's philosophy is in giving back and helping others achieve their trading goals. In his own words: "Judge your trading success by the things you have given up in order to get where you are now!"

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