

TRADING INDICATORS

and

THEIR PRIORITY

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INDICATORS and PRIORITIES

I'm often asked, "What do I look for most on my charts and what priority do I give each of the indicators?"

In some ways it's much like flying a plane. If I'm in a descent my main priority would be my altimeter, so I don't run into the ground. If I'm straight and level I might be watching my airspeed so I don't fly too fast or get too slow.

I believe the same thing happens with the Forex markets. We use different indicators at different times.

For example, if we are waiting to enter a trade we would be watching a different set of indicators than we would if we were already in the trade and watching for an exit point to take a profit. So, here is my checklist of indicators that I follow and the priority I give to each of them.

TO ENTER THE TRADE

#1. First, I look at the MACD bars at the bottom of my chart. Are they changing color or changing direction? This is a very sensitive indicator on both the 5 and 1 minute charts and a significant indicator on the 15 minute chart. You will often see this indicator change color before other indications appear on your charts. It is probably the one I watch most when trying to determine if a trade is shaping up.

#2. The same thing applies to the Heikin-Ashi candlesticks. Once they are in a sustained move they tend to maintain the same color. When they change direction they also change color, although usually not as quickly as the MACD bars. What I look for is a "pullback" that is usually shorter in duration than the trend. In other words there may be only 1-3 candlesticks that change color. If I see the chart creating more than that I become suspicious a change of direction may be occurring.

Another interesting characteristic of the H-A candlesticks is the so-called "wicks," (the lines at the top and bottom) tend to be absent at the bottom of the candlestick when the trend is up. The reverse is true in a downtrend. This can often tip you off when wicks begin appearing at the top and bottom of the candles.

#3. Superimposed on the MACD bars is a line I like to think looks like a roller-coaster. It's called a signal line and I rarely trade against it. I watch to see if it is in a sustained move in one direction or appears to be rolling over or turning up. The problem is it tends to lag. You must often anticipate it's move by observing the MACD bars. Nevertheless if it starts falling I don't want to be buying, or selling if it's rising..

#4. The next thing I watch for is the status of the 3 EMA's and 18 SMA's found on the H-A chart. The 18 bar line is usually very accurate once it changes direction (see chart below). What I watch for is the relationship of the 3 bar line to the 18. It will often come right up to the 18 bar line and then back away. Or, if I see it decisively cross the 18 bar line it generally means a change of direction. You will see that appear on the 18 bar line.

#5. Next, I keep track of what I call the trading line at the bottom of the candlestick chart (the right hand chart if I'm trading with two charts side by side). Once again, I don't like to buy if the line is getting close to a peak or sell if it is approaching a bottom. This indicator is often slow to react (depending on the time frame) so I don't use it as a timing tool but rather to confirm what my other indicators are telling me.

#6. Lastly, I follow the 20 and 30 EMA's (the red and green lines) closely. They are often different on different time frames, but once they cross over each other they usually continue in the indicated direction.

TO EXIT THE TRADE

#1. If I'm using the Latitude Lines to trade with I try to select lines that are contained within the move projected by the AVG strategy. For example, if the move was projected to rise from 1.3520 to 1.3550, I might buy at 1.3530 and exit at 1.3540.

#2. If the signal line and/or trading line reached a peak while trading the above example, I would quickly tighten up my stop or even exit the trade if the MACD bars change color or direction. I try never to allow a winning trade turn into a loser – even if it means just breaking even on the trade.

#3. I depend on the activity of Oscar (on the 15 minute chart) to help me stay in the trend. If I see the numbers changing direction I get ready to exit the trade.

Now let's put all of this into practice.

Today is Monday, February 8th, 2010. These are screen shots taken in sequence during the early morning hours PST, (GMT-8), at Seattle, Washington, USA,

Take a look at the chart below. This is the 5 minute Heikin-Ashi chart of the EUR/USD. The first thing you will notice is the sustained rise from about 7 a.m. to 8 a.m. The candles remained the same color all the way up, while the 18 bar SMA trended higher.

The trend began when the MACD and H-A candlesticks changed color a little before 7 a.m. It was confirmed when the 3 bar EMA crossed decisively over the 18 bar line.

The signal line turned up, and then notice how the blue candlesticks had no wicks underneath them as they continued to rise.



You would have been able to trade from line to line almost effortlessly. Or, you could have started a trade when the MACD bars changed color from red to green. At the top you could have exited the trade as the bars and candlesticks changed to red.

Now I've split the chart in two and created a regular candlestick chart on the right. That way I can watch the red and green EMA's as well as the trading line which is now falling.

The MACD bars have changed color and are declining. The signal line has peaked and the 3 bar EMA line looks like it will be meeting or crossing over the 18 bar line (which is still rising). Prices appear to be topping out, but a change of direction usually takes time after a sustained rise.

Look at the red and green EMA's on the right. They are still rising, and the trading line is getting close to the bottom. This might be just a pullback in a larger up move.

Since the signal line is at a top I would not want to buy this pattern. I might take a small short position to test the waters and then add to it later if I decided a top had actually been made.



Prices are moving higher. The candlesticks have changed color. The trading line looks like it is going higher and the 3 bar line has begun moving higher rather than crossing over the 18 bar line.

What is happening is prices are going to “test” the previous high to see if new buying comes into play. Traders watch for this and are quick to sell if new highs aren’t made.

I’d personally be watching the signal line. New, sustained highs don’t usually begin when the signal line is at a high.

This is the time when patience must be exercised. You don’t want to miss out on perhaps a sizeable upswing, but what if it’s a false move? You just get ground up like hamburger.

You buy, get stopped out, then sell and get stopped out again. You’re getting beat up and with each trade you may lose control and trade with more than you should. Much better to stand aside and wait for more information from your indicators.



Now you can see what I'm talking about. Prices have stopped going higher and are beginning to fall in earnest. Most of the indicators are also falling except for the red and green EMA's. But they are slow to react and will change places with one another if prices go any lower.

Also, check the 3 bar EMA line. It is now touching the 18 bar line and may cross over.

If I had not done so already I would have taken a short position based on what the indicators are telling me.



Prices have now stopped going down. The most recent MACD candle has changed color and the trading line is turning up.

It appears a pullback is going to occur. All traders hate that because it could turn out to be a real change of direction. Do we exit now or wait for the pullback?

A couple of things would tell me to hold on and wait out the pullback. Look at the previous upswing. That was the first pullback. Often there are three. There were only three blue candlesticks also.

Once again I am confident of the signal line. Even though it lags, once it begins trending up or down it usually continues in that direction along with prices.



Here you can see the pullback has occurred and prices did not break out to the upside in a new upswing. The MACD bar and H-A candle have changed color, and the 3 bar EMA has touched and bounced off the downsloping 18 bar SMA.

It's too soon to tell if prices will continue to slide but it looks promising based on the fact they did not take out the previous highs.



Now prices are in a free fall. They have passed through our P1-P2-P3 target (the yellow horizontal line) and have reached a Latitude Line we are happy with, 1.3680. This is just a point we believe they might reverse on us based on the trading line bottoming. I am always happy to exit before a bottom is reached even though prices may still go lower.



Now we see the first indication of the MACD changing color to green. The trading line is turning up. The signal line is getting close to a bottom.

The red and green EMA's have also crossed over. The 18 bar SMA is still in a decline. Prices may bounce up to this line if they rally in a pull back.



But first, here's an accounting of our trades.

TICKET	TYPE	MARKET	PRICE	DATE/TIME
577370736	Take Profit	EUR/USD	+ 15 1.3680	Feb 08, 10:15
577370733	Take Profit	EUR/USD	+ 20 1.3680	Feb 08, 10:15
577370712	Take Profit	EUR/USD	+ 20 1.3680	Feb 08, 10:15
577340138	Sell Market Filled	EUR/USD	1.3695	Feb 08, 08:33
577334435	Sell Market Filled	EUR/USD	1.3700	Feb 08, 08:20
577331806	Sell Market Filled	EUR/USD	1.3700	Feb 08, 08:14

What I want you to notice here is the smooth change of color of the MACD bars. Prices are still in a decline but are rallying (pulling back) because they have been temporarily “oversold.”

We don’t know how far up prices may go, but we can use our trading line and MACD bars to help us. We would only want to sell this kind of market. It is an easy trade because we know the major direction is down. All we have to do is time our entry using a Latitude Line.



The 18 bar SMA line is still declining, as well as the trading line. The MACD bars and H-A candles have changed color. It looks like the decline is intact.

But notice the signal line. It is rising, signaling that this movement may be coming to an end. We will have to be careful.



Prices have fallen from 1.3680 to 1.3670. We have been able to enter the trade twice as prices touched 1.3680, and then make an additional trade halfway down at 1.3675. We could do this because we were confident of the move based on our indicators.

The candles were changing color, the red and green EMA's were still declining, the 3 bar EMA line bounced off the 18 bar line and the trading line was in a decline.



Here were the results:

TICKET	TYPE	MARKET	PRICE	DATE/TIME
577396833	Take Profit	EUR/USD	+ 5 1.3670	Feb 08, 12:02
577396830	Take Profit	EUR/USD	+ 10 1.3670	Feb 08, 12:02
577396823	Take Profit	EUR/USD	+ 10 1.3670	Feb 08, 12:02
577390983	Sell Market Filled	EUR/USD	1.3675	Feb 08, 11:38
577387883	Sell Market Filled	EUR/USD	1.3680	Feb 08, 11:23
577384175	Sell Market Filled	EUR/USD	1.3680	Feb 08, 11:06
577370736	Take Profit	EUR/USD	1.3680	Feb 08, 10:15

Although these trades were made in real time with real money, you should be aware they may or may not be indicative of what you may experience in your own trading. Trades displayed should be used only as an illustration of how I trade the Forex markets and are not a recommendation to buy or sell any Forex product.