Presents

Trade Forex Responsibly

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Quick Introduction

What's in here? Many arrive to forex trading and just burn out their account because they don't trade responsibly. This starts with choosing the forex broker, and goes through all the important choices that are made in every trade and also between trades.

This guide touches the key points of trading forex more responsibly and provides many practical tips that only help avoiding the pitfalls but also provide tools for balanced, successful and sustainable trading.

Let's start!

Disclaimer

Foreign exchange (forex) trading carries a high level of risk and may not be suitable for all investors. The risk grows as the leverage is higher. Investment objectives, risk appetite and the trader' level of experience should be carefully weighed before entering the forex market. There is always a possibility of losing some or all of your initial investment / deposit, so you should not invest money which is which it can't afford to lose. The high risk that is involved with currency trading must be known to you. Please ask for advice from an independent financial advisor before entering this market. Any comments made on Forex Crunch or on other sites that have received permission to republish the content originating on Forex Crunch reflect the opinions of the individual authors and do not necessarily represent the opinions of any of Forex Crunch's authorized authors. Forex Crunch has not verified the accuracy or basis-in-fact of any claim or statement made by any independent author: Omissions and errors may occur. Any news, analysis, opinion, price quote or any other information contained on Forex Crunch and permitted re-published content should be taken as general market commentary. This is by no means investment advice. Forex Crunch will not accept liability for any damage, loss, including without limitation to, any profit loss, which may either arise directly or indirectly from use of such information.

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Money Management

Isn't money management a nice buzzword? Many forex brokers flash around this nice phrase. I'm sure you've heard it many times. How can you turn this buzzword into practical, actionable advice?

As with any type of investment, there is risk. The idea is to control your risk and be aware of it. This will save you from the infamous margin call, as well as let you control your account in a better way.

1. **Limit the risk**: When you open a trade, place a stop loss order to get you out of your trade and prevent a situation where you lose too much. This states the obvious for the vast majority of traders reading this, but I still know some traders who don't use a stop loss order. This precarious deed is done also by people who work at forex broker firms and trade with their account. Sad but true.
2. **How much money are you risking**: Many traders calculate the risk / reward ratio. Some look for 2:1 or 3:1. That's great. But how many dollars are you actually risking? This data is available with most brokers. Is this sum too high? In that case, there are two mathematical options to reduce the amount of money you risk:
    a. **Tighten your Stop Loss**: In this way, less money is at risk. Sounds good? Not exactly. Perhaps your new Stop Loss is too tight and will yield an immediate loss to that position. Lowering the amount of money you risk doesn't mean raising the chances of a loss! The stop loss point should be based on your analysis: technical, fundamental or a combination. It shouldn't be based on the amount of money risked.
    b. **Lowering the position size**: With a lower position size, you will still get to place the stop loss point in the right place for you, but the money that is risked will be lower. Yes, also the rewards side will be lower. And yes, it is tempting to trade large positions. But remember:

this is leveraged money, not real money that you have. By lowering the position size you still get to trade your position in full, and just risk less cash.

3. **How much of your account are you risking?** OK, you already see the amount of dollars that you are risking, but saying it bluntly: what is your burn rate? Let's say you have an account of $1000 and you risk 20%. Now your first trade has gone bad, and you lose $200. You stick to your method but it doesn't work out again and you lose another $200. In 5 trades you are out, liquidated, margin-called. If you are new to forex trading, you are likely to make more mistakes and lose more in your initial trades. Risking a big portion of your account means that you can burn out quickly before you had enough time to learn, improve and win enough trades.

A rule of thumb: **Don't risk more than 2% of your account!**

I know this sounds very strict, but this rule will help you survive, learn and eventually increase your chances of having sustainable profits in forex trading.

A **forex demo account** is very useful for practice, but **it doesn't fully simulate the real thing** – not in execution (detailed later) and not in the emotional stress. Having enough opportunities to trade helps you trade better.

Trade With the Trend

You've probably heard the expression: "Make the trend your friend". For many, this basic idea has already been forgotten and regarded as yet another cliché. Nevertheless, it is still very relevant.

If your system involves looking at 1 hour charts, check out the 4 hours charts and the daily charts to get the bigger picture. What is the general direction of your currency pair?

Are the larger scoped charts headed lower when you place a long position? Maybe it is time to rethink your position.

Sure, you can money on corrections. If the pair approached a resistance line and the general direction is up, you may short the pair when it approaches the line and profit off the bounce. But let's remember two things:

1. This could be the break: Perhaps the pair has enough momentum to cross the line this time. If the general direction is higher, you don't want to be the contrarian in this case, as your trade will lose.
2. Corrections are smaller: Breakouts are usually stronger than corrections. Many traders use Fibonacci lines to measure the potential of the correction. Using this theory, a correction is 38.2%, 50% or 61.2% of the move while a breakout has a larger potential of covering 100% of the previous range, according to the same theories.

Of course, breakouts can be false, and may not yield the desired results. **There are ways to cope with false breakouts**, and in many cases, the preliminary false breakout is a preparation for the big move. The wider trend longer term trend has a better chance of being the winning one.

Trying to outsmart the markets sounds bold and can make a great impression on your friends, but you won't be running to boast your victories to your friends if this strategy turns out to be a losing one.

Sideways

When the currency pair of choice trades sideways, there is no trend in theory and both directions can work. Also in this case, it is important to have another look and try to identify if any direction, up or down is emerging.

Has the pair recently been trading in an uptrend or downtrend channel within the current range? What is the news about the currencies in question? In some cases, a potential direction can emerge for the pair and you could be aware of this and take advantage of this.

Flat ranges aren't forever. The pair will eventually break out, and making a deeper analysis can help you find the right direction.

Use Higher Time Frames

As hinted in the previous chapter, you need to see the big picture. Seeing the big picture will help you identify the general trend, but may not be enough.

Is your system based on using 1 hour charts? That's not too bad. But how about testing it on a wider timeframe of 2 hour charts? 4 hour charts, or more? In many cases, back testing your strategy on a higher time frame can prove to be more profitable.

Why? You reduce the noise

You can trade with the trend, perform a perfect analysis and have your trade go in your favor. But, suddenly some exporter threw a big order into the markets and a sudden spike triggers your stop loss order.

This also applies for rumors. Market rumors are common and commonly untrue. Some big market participants create rumors for their own short term interests, and you are thrown out of the trade. A low time frame system means that you don't have time to analyze these rumors.

Zoom out to the higher time frame and there's no noise there.

Spread and execution

In lower time frames, the number of pips in your system is smaller: this means that if the spread might be too high for your nice theory. It can make the difference between a successful trade and a losing one. Using higher time frames, spreads are not an issue. A difference of a pip or two in spreads is almost meaningless when the scope of the trade is large.

Execution: this is an important point when choosing a broker, a point that will be discussed later on, but is relevant also now. With low time frames, you rely on your broker to execute your order as is: what you see is what you get. You also rely on the broker to execute the stop loss and take profit orders with a higher degree of precision. What happens on a re-quote? You miss your opportunity.

Similar with spreads, even a slow or sloppy execution by your broker doesn't alter the basic logic of your trade and doesn't make the difference between a losing and a winning trade.

What if you can't find a nice setup for your system on a higher timeframe? If you still want to stick to it, perhaps another currency pair can be a better match for your system at a higher time frame.

And perhaps it is time to consider another forex system. Forex systems don't work all the time anyway.

Trade With a Registered Broker

There are a lot of forex brokers out there. The forex industry is quite spread out: there are many players in different countries. Competition is great and some small forex brokers compete with the big boys is blessed. Many industries are controlled by a few powerful entities, and it is great that forex isn't one of them.

What does regulation provide?

- **Minimum size**: Regulators require that a broker has a minimum amount of capital. This means that the broker has lower chances of going broke too fast and taking your money on the way.
- **Requirements**: Regulation is needed to ensure your rights as a trader. This starts from proper disclaimers, something you may dismiss, providing some protection against having the broker take the opposite position against you in a way that harms you, and lots more. With some unregulated brokers, you may find it very hard to withdraw your money. This kind of behavior still exists unfortunately.
- **Someone to complain to**: Does your forex broker treat you badly? At least you have someone to complain to, someone who will seriously look at your complaint and will investigate it. In many cases, the fear of a complaint makes the brokers avoid malpractice in the first place.

Some unregulated brokers may look more shiny and may promise you much more than a regulated broker offers. But will they live up to their promise? The level of doubt is much higher with unregistered brokers.

Not all regulators were born equal. Some regulators are tough in regulations but don't bother enforcing them. Some are just a rubber stamp.

Some brokers may claim to be regulated. Don't believe them! **Check it out on the official sites of the regulators** listed below, and make a check on them using the internet. **Here are some quick methods**.

Here are 4 leading bodies

- NFA (together with CFTC in the US)
- FSA (In the UK(
- FINMA (Switzerland) which also has a blacklist.
- ASIC (Australia).

With some unregulated brokers, you can be the perfect trader, and that's where the trouble begins. Seeing a successful trader triggers the alarm bells. You suddenly see your stop loss orders triggered when the market wasn't even close to your order. Perhaps some of the functionality is denied and execution, our next point, may turn out to be very poor.

With an unregulated broker, you have no one to complain to, apart from forums on the web. This may help in relieving the pain, but it will not get your money back. Hopefully you are able to withdraw your funds.

These stories happen more than people are willing to admit. You don't usually boast when you are deceived. Trading with a regulated broker significantly lowers the risk.

Execution is Everything

Carefully choosing a forex broker isn't an easy task. There are lots of brokers out there and each one has a well designed sign up page with "exciting" features.

Assuming you took the advice in the previous chapter and decided to trade only with a registered broker, the options are still wide.

So what should you take into account before opening an account?

Execution.

What does it mean: this means that when you see a quote on your screen and hit the trade button, the order will be executed as is. Sounds simple, doesn't it? Well, it should be simple, but with some brokers, this isn't always the case. With unregulated brokers, you can find yourself buying at a higher price than seen on the screen, or selling lower. This isn't too common, but not unheard of.

The more common case is an error message saying that your trade could not be realized: "Please try again". When you try again, the price may have moved against you, or you may get the same error message again and again.

This is relevant also with orders: they aren't executed when the market reached your stop loss or take profit point. That's bad, but there's worse: catching your stop loss point when the market was far away from you.

The broker isn't always to blame, but there are better and worse.

No broker has perfect execution. Even the best ones with the best access to liquidity providers can miss orders. This is usually due to extreme market conditions, such as when US Non-Farm Payrolls are released, or when there's another breaking event. Don't run blaming the broker.

Market conditions can be extreme, but they are extreme for all brokers at the same time. So, some are better than others, and differences can be significant.

Some brokers publish their execution statistics, and make comparison easy. In the US, brokers are required to publish the profitability of their clients on a quarterly basis, but aren't required to publish the execution rates. Hopefully this will become the norm or the regulation.

For those who don't publish their numbers, you can just ask them. Remember, you are the client and you deserve to have this important piece of information before putting your trust and your money with the broker.

If the broker is reluctant to share the data, ask around. Note that some forex broker reviews are biased and are not real. It's also important to note that some of the participants in various websites aren't always disclosing their relationship: it can be a rave review about their own company or throwing mud at a competitor. So, take these words with a grain of salt.

If you can find a trustworthy person who is a current client of the broker you are wondering about, that's the best evidence that you can get.

In the next chapter, we'll discuss another important matter that makes a difference – not necessarily what you think.

Account Size Does Matter

After choosing a forex broker, and testing the platform with a demo account, you now feel ready to deposit funds and play the real game. How much should you deposit? Certainly not more than you can afford to lose. Yet a bigger sum has quite a few advantages that can make a difference between a winning account and a losing one.

Upgraded status

A bigger account size means an upgraded status with the broker. Spreads can be tighter, meaning you earn a bit more and lose a bit less in every trade. This is an obvious advantage but definitely not the most important one.

In some cases, a bigger account means a better customer service with the broker and perhaps other perks. Brokers may offer you enhanced mobile services for example.

More time to learn

With more money in the account, it is easier to implement money management principles. Risking no more than 2% of your account in one trade can be done with more ease: you don't have to make a big compromise on the size of the trade. In addition, you still enjoy better spreads on the trades, even the smaller ones.

So, you get to make many trades, not risk too much of your account all at once and still enjoy better spreads. But that is still not the most important point.

Taking it seriously

When you deposit a significant sum into a forex account, you are going to take things more seriously. That's how it works with many things in life. You may be have a talent in some field, but there's so much your talent can take you. Working hard, committing to something and being serious makes a difference even for the most talented people in any field.

As aforementioned, don't risk what you can't afford to lose. Yet if deposit a small sum, you'll treat forex trading without care, as a form of entertainment or as buying a lottery card.

Are you here only for entertainment? Or do you want to make money as well?

By assuming that you'll lose everything anyway, you are making a prophecy that is self fulfilling. Instead of testing trades on demo accounts, you'll rush to throw your money into a real account. The result is throwing your money away. Instead of carefully planning a trade and carefully executing your plan, you'll just go with any gut feeling you have at the moment. If you enjoy this, so be it.

But if you want to take things seriously and increase your chance of profiting, serious trading begins not from the first trade, but from the initial deposit.

You don't have to have aspirations of becoming a forex professional. **The road is long and consists of a few important steps**. But starting from a significant deposit that will make you treat the account very seriously will sure make your trading experience a more thorough one, and eventually a more successful one.

Pacing

In order to improve your trading, the frequency of your trading deserves special attention. In order to have better control over your account, it is advisable to pace yourself.

Some traders have a winning streak and they extend the times in which they trade. Eventually, their nose is attached to the screen for too many hours, and they begin seeing trades that are never there. This also has bad implications on other things in life, and isn't healthy at all.

The same applies for traders who have a losing streak: they may want to take revenge on Mr. Market. Well, the market is bigger and stronger, and this is the fast lane to burning out.

This can be avoided by planning the times in which you trade.

Scheduling means that you allocate time that is dedicated to forex trading. Being concentrated on this one task and avoiding distractions will raise your chances of winning. This applies to every single trade and also to the long run: having a successful record.

So when should you trade? The timing of trading depends on quite a few factors.

- **Trading type**: Are you looking for the big moves? If the answer is yes, go for the sessions with the higher volatility – the New York and or the London sessions. If you're looking for range trading at more quiet times, look for other times of day.
- **Person type**: If you are a "morning person", you have a better chance of winning in the morning, when you are at your best. If you are night owl, trading at night may be best for you. The idea is to take trading seriously, and listen to your body, not only to the charts.
- **Life limits**: Do you have a full time day job? Are you a family man? Life is not only a bunch of trade opportunities. Adjusting the timing of trading to your life yields a better personal life and a higher chance of taking profits. Having them collide too often will not get anything done.

Ideally you would be able to find the perfect timing when all these factors come together. This isn't always possible. Try to find the right balance in order to avoid addiction to forex. I've seen too many traders who lost their head to the charts. They didn't necessarily lose too much money, but they lost touch with reality and weren't successful at trading either.

Trading in scheduled times

Scheduling doesn't mean trading at every session. In some cases, you will allocate time, test a few possible setups and reach a conclusion that there is nothing out there. **Don't force yourself into a trade**.

Testing the markets and deciding not to trade is a perfectly sound decision that can save you money.

Have you entered a position, closed it and still have time left? Don't run for the next trade. It's better to take a break before the next trade. As mentioned above, running after the next profit can be disastrous, and so can the sense of avenging.

So, it's important to pace yourself.

Learn How to Lose

Winning is fun and useful, but losing is also part of the game. Successful traders lose quite a few trades, but know how to minimize their losses and cope with the situation. In order to win in the long run, you often need to know how to lose in the short run and remain in the game.

Have you lost the trade? Analyze it. Analyzing doesn't have to take place immediately. Perhaps you will find it more useful taking some distance from the actual trade. This will allow you to be less emotional and to analyze the trade without the emotional stress.

Trying to take revenge or entering getting desperate in any other form isn't helpful.

What went wrong?

- **Did you indeed follow your plan?** Perhaps you missed some calculation during the preparations. Perhaps you bent the rules and wanted to go ahead with the trade. Or maybe you made unnecessary changes when the position was open. Well, now you are aware of this, and your next trade will probably be a more precise one.
- **Is your plan satisfactory most times, and sometimes loses?** That's OK as well. Just be aware of that. Any plan, has its losing trades. A good plan doesn't win every trade, but wins in the long run. This means that the risk/reward ratio is low enough, and that the win/lose ratio is good enough.
- **Do you need to change the plan?** Before making changes to your plan or replacing it altogether, please check the two points above. If you are certain that you have followed your plan and that it isn't just one of the normal losses, it is time for a change. **5 straight losing trades**, given that the implementation was a perfect, is good enough for making changes.

Changes can include

- **Tweaking some of the parameters of your plan**: You can backtest your losing trades. It's not so fun digging into a failed trade and playing a hypothetical "what if" game. But applying the same "what ifs" to all the trades of the same type may yield a difference. Would a small change make a difference? Perhaps that's all you need.
- **Switching to different currency pair**: This is harder to examine using the losing trades, as currencies don't have the exact same patterns. But if your currency pair used to trade sideways and now it has broken out and extended the trading range (or the opposite), perhaps the system will not work anymore.
- **Finding a new plan**: Sometimes patterns change in all pairs, and sometimes your system wasn't optimal in the first place. If you are certain that this is the case, it's time for a change. Refusing to admit that a change is needed is quite common after believing that your system is successful. But we aren't here for being righteous, but rather for winning. If the system isn't useful, just move on.

Enough about losing. Have you won the trade? Analyze it as well. Was your win part of the system? Great. Was it by chance? Feel lucky and humble. Many traders become euphoric after winning a trade using their gut feeling. This means that they are on the fast lane to burning out their account. Being overconfident is also harmful.

Use More Predictable Currency Pairs

Some currency pairs tend to follow patterns in a much more readable way. With the best ones, patterns can be easily seen with the naked eye, before placing the first line on the chart. It is important to be aware of this before looking for a trade.

With more predictable currency pairs, clear support and resistance lines will be respected in a better manner. This means that when the pair approaches the line, its movement will slow down. Does it lack the momentum to break? This line will serve as a bouncing spot, and the price will return towards the middle of the range.

And when the pair has enough momentum to make the break, it will leave the line behind and eventually settle in a new range, higher or lower. The same applies for uptrend or downtrend channels.

The less predictable pairs are just a mess. Some are very choppy. Your system may work with range trading, but these pairs just chop their way out of range for false and unpredictable breakouts.

Some currency pairs will work with your system in a better manner. Some will not. If no pair matches your system, then it is time to say goodbye to your system. But if it does work with some pairs, they will most probably be the more predictable ones with any system.

Which pairs are more predictable?

A general rule is that the currency pairs with more trading volume tend to be more predictable. So, exotic currencies or weird crosses may not fit into this definition.

But this is definitely not a strict rule, and it currently doesn't apply for the most popular pair: ongoing debt crisis in Europe makes EUR/USD a less predictable pair despite its huge volume.

In addition, trading patterns aren't there forever. Fundamentals have a great effect on the patterns on the charts and change all the time.

On Forex Crunch, a list of the Top 5 predictable pairs is published on a quarterly basis. **Here is the latest for Q4 2011**.

While I fully stand behind this list, the pairs listed there will not necessarily work for you. Take it as a general guidance.

- You should examine the charts on your own to see what catches your eye. That's a first.
- Then, check out which pairs really play well with your system.
- And last, don't forget to retest it over time.

As aforementioned, patterns change all the time. Scheduling a retest of currency pairs once a quarter will help you avoid the situation where you are losing trades. Perhaps your system is great, but it is time to move to another pair.

Additional Resources

General Articles

- **5 Points on When to Go Pro** – Successful at forex trading and considering of doing it full time? There are a few steps on the way.
- **How to Choose a Forex Broker in 2011** – There are quite a few tools you can use before making this important decision.
- **How About Investing in Forex?** – Foreign exchange doesn't necessarily have to involve active trading, but can be

- **Risk Factor Explained** – A deeper explanation about why the dollar falls on good figures and vice versa and under what conditions this will end.
- **Trading in Range or Catching Breakouts?** – What is your style? And what to look out for.

Recommended Sites:

- **TradingNrg** – For all you need to know about gold, oil and other commodities.
- **BO Crunch** – All you need to know about trading binary options.

That's it! I welcome feedback, comments, suggestions, complaints and anything you wish to tell me about this eBook. Please send any feedback to yohay@forexcrunch.com.

Happy forex trading!