FOREX TRADING – PART 2

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INTRODUCTION

'Forex' simply stands for Foreign exchange. Forex is the largest financial market in the world, but it is not a physical market, and therefore has no central point. If you Buy one currency using another, whether in your local bank, on a online exchange or at the airport, you are participating in the Forex Market.

In Forex trading, we buy one currency using another. As with all markets, the current price of a currency is based on what the market is prepared to pay for it. In Forex, this is called the 'exchange rate' between currencies, often simply referred to as 'the rate'. The exchange rate is simply a measure of what the market thinks one unit of one currency is worth in a unit of another currency.

Supply and Demand

Market relies on these principles of supply and demand. Demand refers to how much (quantity) of a product or service is desired by buyers. The quantity demanded is the amount of a product people are willing to buy at a certain price; the relationship between price and quantity demanded is known as the demand relationship. Supply represents how much the market can offer.

A currency pair is the quotation of two different currencies, with the value of one currency being quoted against the other. The first listed currency of a currency pair is called the base currency, and the second currency is called the quote currency

Bid and Ask

The term bid and asks refers to the best potential price that buyers and sellers in the marketplace are willing to transact at. In other words, bid and ask refers to the best price at which a security can be sold and/or bought at the current time.

The Bid Price

The bid price is the price that an investor is willing to pay for the security.

For example, if an investor wanted to sell a stock, he or she would need to determine how much someone is willing to pay for it. It can be done by looking at the bid price – the highest that someone is willing to pay for the stock.

The Ask Price

The ask price is the price that an investor is willing to sell the security for.

For example, if an investor wanted to buy a stock, he or she would need to determine how much someone is willing to sell it for. It can be done by looking at the ask price – the highest that someone is willing to sell the stock for.

Understanding Bid and Ask

Bid and ask is a very important concept that many retail investors overlook when transacting. It is important to note that the current stock price is the price of the last trade – a historical price. On the other hand, the bid and ask are the prices that buyers and sellers are willing to trade securities at. In essence, bid represents the demand while spread represents the supply of the security.

For example, if the current stock quotation includes a bid of $13 and an ask of $13.20, an investor looking to purchase the stock would pay $13.20 while an investor looking to sell the stock would sell it at $13.

Example of Bid and Ask

John is a retail investor looking to purchase stocks of Security A. He notices the current stock price of Security A is at $173 and decides to log onto his brokerage account and purchase 10 shares (total cost = $1,730). To his confusion, when he executed the buy order, he noticed that the total cost came out to $1,731.

John assumed that it must've been an error, as the stock price of Security A is $173. He later realizes that the current stock price of $173 is the price of the last traded stock of Security A and that he would've to pay the asking price of $173.10 per stock of Security A.

Bid-Ask Spread

The difference between the bid and ask prices is referred to as the bid-ask spread. The bid-ask spread benefits the market maker and represents the market-maker's profit. It is an important factor to take into consideration when trading securities, as it is essentially a hidden cost that is incurred during trading.

For example, if a security received a bid of $10 and an ask of $11, an investor would expect to lose $1 or 9% of their investment if they bought at the asking price of $11 and then immediately changed their mind and sold at the bid price of $10.

When the security is highly traded (liquid), the spread will be low. On the other hand, when the security is seldom traded (illiquid), they spread will be larger. For example, the bid-ask spread of Facebook Inc., a highly traded stock with a 50-day average daily volume of 25 million, is one (1) cent.

Participants in Foreign Exchange Market

Participants in Foreign exchange market can be categorized into five major groups, viz.; commercial banks, Foreign exchange brokers, Central bank, MNCs and Individuals and Small businesses.

Commercial Banks

The major participants in the foreign exchange market are the large Commercial banks who provide the core of market. As many as 100 to 200 banks across the globe actively "make the market" in the foreign exchange. These banks serve their retail clients, the bank customers, in conducting foreign commerce or making international investment in financial assets that require foreign exchange.

These banks operate in the foreign exchange market at two levels. At the retail level, they deal with their customers-corporations, exporters and so forth. At the wholesale level, banks maintain an inert bank market in foreign exchange either directly or through specialized foreign exchange brokers.

The bulk of activity in the foreign exchange market is conducted in an inter-bank wholesale market-a network of large international banks and brokers. Whenever a bank buys a currency in the foreign currency market, it is simultaneously selling another currency.

A bank that has committed itself to buy a certain particular currency is said to have long position in that currency. A short-term position occurs when the bank is committed to selling amounts of that currency exceeding its commitments to purchase it.

Foreign Exchange Brokers

Foreign exchange brokers also operate in the international currency market. They act as agents who facilitate trading between dealers. Unlike the banks, brokers serve merely as matchmakers and do not put their own money at risk.

They actively and constantly monitor exchange rates offered by the major international banks through computerized systems such as Reuters and are able to find quickly an opposite party for a client without revealing the identity of either party until a transaction has been agreed upon. This is why inter-bank traders use a broker primarily to disseminate as quickly as possible a currency quote to many other dealers.

Central banks

Another important player in the foreign market is Central bank of the various countries. Central banks frequently intervene in the market to maintain the exchange rates of their currencies within a desired range and to smooth fluctuations within that range. The level of the bank's intervention will depend upon the exchange rate regime flowed by the given country's Central bank.

MNCs

MNCs are the major non-bank participants in the forward market as they exchange cash flows associated with their multinational operations. MNCs often contract to either pay or receive fixed amounts in foreign currencies at future dates, so they are exposed to

foreign currency risk. This is why they often hedge these future cash flows through the inter-bank forward exchange market.

Individuals and Small Businesses

Individuals and small businesses also use foreign exchange market to facilitate execution of commercial or investment transactions. The foreign needs of these players are usually small and account for only a fraction of all foreign exchange transactions. Even then they are very important participants in the market. Some of these participants use the market to hedge foreign exchange risk.

Segments of Foreign Exchange Market

There are two segments of foreign exchange market, viz., Spot Market and Forward Market.

Spot Market

In spot market currencies are exchanged immediately on the spot. This market is used when a firm wants to change one currency for another on the spot. The procedure is very simple. A banker can either handle the transaction for the firm or may have it handled by another bank.

Within minutes the firm knows exactly how many units of one currency are to be received or paid for a certain number of units of another currency.

For instance, a US firm wants to buy 4000 books from a British Publisher. The Publisher wants four thousand British Pounds for the books so that the American firm needs to change some of its dollars into pounds to pay for the books. If the British Pound is being exchanged, say, for US $ 1.70, then £ 4,000 equals $ 6800.

The US firm simply pays $ 6800 to its bank and the bank exchanges the dollars for 4000 £ to pay the British Publisher.

In the Spot market risks are always involved in any particular currency. Regardless of what currency a firm holds or expects to hold, the exchange rate may change and the firm may end up with a currency that declines in values if it is unlucky or not careful.

There are also risks that what the firm owes or will owe may be stated in a currency that becomes more valuable and, as such possibly harder to obtain and use to pay the obligation.

Forward Market

Forward market has come into existence to avoid uncertainties. In Forward market, a forward contract about which currencies are to be traded, when the exchange is to occur, how much of each currency is involved, and which side of the contract each party is entered into between the firms.

With this contract, a firm eliminates one uncertainty, the exchange rate risk of not knowing what it will receive or pay in future. However, it may be noted that any possible gains in exchange rate changes are also estimated and the contract may cost more than it turns out to be worth.

For example, suppose that the ninety-day forward price of the British pound is 2.000 (US$ 2.00 per £) or quoted £ 0.5000 per US $, and that the current spot price is US $ 1.650. If a firm enters into a forward contract at the forward exchange rate, it indicates a preference for this forward rate to the unknown rate that will be quoted ninety days from now in the spot market.

However, if the spot price of the pound increases by 100 per cent during the next 90 days, the pound would be US $ 3.3000 and the £ 5,00,000 could be converted into US $ 1,650,000 The forward market, therefore, can remove the uncertainty of not knowing how much the firm will receive or pay. But it creates one uncertainty-whether the firm might have been better off by waiting.

TYPES OF ORDERS

Below are the Major types of orders placed in Forex trading:-

I. Market Order

A market order is a buy or sells order to be executed immediately at the current market prices. As long as there are willing sellers and buyers, market orders are filled. Market orders are used when certainty of execution is a priority over the price of execution. A market order is the simplest of the order types.

II. Limit Entry Order

A limit entry is an order placed to either buy below the market or sell above the market at a certain price. For example, EUR/USD is currently trading at 1.2050. You want to go short if the price reaches 1.2070 and long if it reaches to 1.2030.

III. Stop Entry Order

A stop entry order is an order placed to buy above the market or sell below the market at a certain price.

IV. Stop Loss Order

A stop-loss is an order that you place with in order to sell a security when it reaches a particular price. A stop-loss order is developed to reduce a trader's loss on a position in a security.

V. Trailing Stop

A sell trailing stop order sets the stop price at a fixed amount below the market price with an attached "trailing" amount. As the market price rises, the stop price rises by the trail amount, but if the stock price falls, the stop loss price doesn't change, and a market order is submitted when the stop price is hit.

Types of Market Analysis

Essentially, there are two types of analysis traders can undertake when looking at markets:

Fundamental Analysis

Fundamental analysis is a method of evaluating securities by attempting to measure the intrinsic value of a stock. Fundamental analysts study everything from the overall economy and industry conditions to the financial condition and management of Companies. Earning expenses, assets and liabilities are all important characteristics to fundamental analysts.

Technical Analysis

Technical analysis differs from fundamental analysis in that the stock's price and volume are the only inputs. The core assumption is that all known fundamentals are factored into price; thus, there is no need to pay close attention to them. Technical analysts do not attempt to measure a security's intrinsic value, but instead use stock charts to identify patterns and trends that suggest what a stock will do in the future.

TRADING PLAN

You can learn a lot about the currency market. You can have a great system for trading but without a good trading plan and the discipline to stick to it, you will NEVER be profitable. Your trading plan will be a constant reminder of how you will make money trading the currency market. A plan is not required, and if you make a living by trading and do not have a plan you will be a market genius. Let us give you some good reasons why you should have a trading plan.

Why Do You Need a Trading Plan?

- A plan will keep you headed in the right direction.

You need to develop consistency in your trading. You should have a routine so you can measure your success as a trader. You may have a sound trading system and always break the rules. If this is the case you will never know how good your system is and how good you are as a trader. Read your plan every day, follow it and you will stay on target with your goals.

- Successful trading is not just a hobby it is a business and a successful business will have a plan.

I have never known of a successful business that did not start out with a plan. By sticking to the plan they continued to be successful. If they stop following there plan then they will become weak in there industry and fall by the wayside. As your trading business progresses you may alter your trading plan. But you still have a plan.

The difference between the winning traders and the losing traders is a plan. If you have a good plan (developed over time) and you stick to it, you can become successful! You may have a simple plan or a complex plan but to be successful you need to FOLLOW YOUR PLAN.

Basics for Your Plan

Trading System: The trading system is the foundation of your trading plan. You should test it for at least one month by your Pre Launch Trading and Demo trading. Include all the important information about your system: a. Time frames you will use. b. The entry and exit signals you will use. c. The maxim percentage you will risk on each trade. d. How many lots you will trade.

Example: I trade the US market. I trade in the direction of the trend on the 4 hour chart. I trade when I get at least two confirming signals (on the time frame that is easiest to read at the time I am trading). I will always start each trade with only one lot. I will add

on to the trade as new signals present themselves. I will exit all positions when my manual trailing stop is hit or when two price bars close below the purple line.

Trading Routine: A trading routine is an important part of your trading plan. It will direct you:

a. When you will analyze the market and plan your trades

b. When you will watch the market to place trades

c. When you will check the market during the day

Example: I will analyze the market each evening when I get home from work and just before I go to bed. I will watch the market for an hour in the morning before I go to work. I will check the market when each new 4 hour bar is formed when I am awake.

Your Trading Journal

Make sure you log the details of each trade and record the reasons for the trade in your Trade Tracker sheet. Later down the road you can look back and evaluate your trades and see how you are progressing. I've looked back at my trade journal and have seen just how much I've grown as a trader. My first entries were very basic and as I've progressed, my trades make more sense to me now. I've gained a lot of confidence throughout my career and by looking back at my trades, I've really been able to evaluate myself and see if I am getting closer to my goals. This tool will help you tremendously in the long run, so take a few minutes each day and log your trades. You'll be happy you did!

SWOT ANALYSIS

SWOT is a strategic planning tool used to evaluate the strengths, weaknesses, opportunities, and threats to a project. It involves specifying the objective of the project and identifying the internal and external factors that are favorable and unfavorable to achieving that objective. The strengths and weaknesses usually arise from within an organization, and the opportunities and threats from external sources.

The SWOT analysis is an important part of the project planning process:

- **Strengths**: attributes of the organization that help achieve the project objective.
- **Weaknesses**: attributes of the organization that stop achievement of the project objective.
- **Opportunities**: external conditions that help achieve the project objective.
- **Threats**: external conditions that could damage the project.

Use the following grid to record each factor:

Strengths (internal factors)	**Weaknesses (internal factors)**
Track record (similar successes)	Gaps in knowledge and expertise
Resource availability	Timescale and deadlines
Skill levels	Budget and funding
Processes and systems	Competing projects
Reputation	Processes and systems
Opportunities (external factors)	**Threats (external factors)**
Technology and infrastructure development	Political influences
Changing consumer behavior	Environmental factors
Emerging and developing markets	Competitor activity
New innovations (R&D)	Economy
Market demand	Seasonal effects

Advantages of SWOT

- Straightforward and only costs time to do.

- Produces new ideas to help take advantage of an organization's strengths and defends against threats.
- Awareness of political and environmental threats allows an organization to have response plans prepared.

Disadvantages of SWOT

- May persuade organizations to compile lists rather than think about what is essential to achieving objectives.
- Presents lists uncritically and without clear prioritization so, for example, weak opportunities may appear to balance strong threats.
- Usually, a simple list and not critically presented.

RISK OF FOREX MARKET

This risk usually affects businesses that export and/or import, but it can also affect investors making international investments. For example, if money must be converted to another currency to make a certain investment, then any changes in the currency exchange rate will cause that investment's value to either decrease or increase when the investment is sold and converted back into the original currency.

I. Types of Risk

- **Exchange Rate Risk** – refers to the fluctuations in currency prices over a trading period. Prices can fall rapidly resulting in substantial losses unless stop loss orders are used when trading FOREX. Stop loss orders specify that the open position should be closed if currency prices pass a predetermined level. Stop loss orders can be used in conjunction with limit orders to automate FOREX trading – limit orders specify an open position should be closed at a specified profit target.
- **Interest Rate Risk** – can result from discrepancies between the interest rates in the two countries represented by the currency pair in a FOREX quote. This discrepancy can result in variations from the expected profit or loss of a particular FOREX transaction.
- **Credit Risk** – is the possibility that one party in a FOREX transaction may not honor their debt when the deal is closed. This may happen when a bank or financial institution declares insolvency. Credit risk is minimized by dealing on regulated exchanges which require members to be monitored for credit worthiness.
- **Country Risk** – is associated with governments that may become involved in foreign exchange markets by limiting the flow of currency. There is more country

risk associated with 'exotic' currencies than with major currencies that allow the free trading of their currency.

Types of Foreign Exchange Risks\ Exposure

There are two sorts of foreign exchange risks or exposures. The term exposure refers to the degree to which a company is affected by exchange rate changes.

- Transaction Exposure
- Translation exposure (Accounting exposure)
- Economic Exposure Operating Exposure
- Operating Exposure

TRANSACTION EXPOSURE

Transaction exposure is the exposure that arises from foreign currency denominated transactions which an entity is committed to complete. It arises from contractual, foreign currency, future cash flows. For example, if a firm has entered into a contract to sell computers at a fixed price denominated in a foreign currency, the firm would be exposed to exchange rate movements till it receives the payment and converts the receipts into domestic currency. The exposure of a company in a particular currency is measured in net terms, i.e. after netting off potential cash inflows with outflows.

Suppose that a company is exporting deutsche mark and while costing the transaction had reckoned on getting say Rs 24 per mark. By the time the exchange transaction materializes i.e. the export is affected and the mark sold for rupees, the exchange rate moved to say Rs 20 per mark. The profitability of the export transaction can be completely wiped out by the movement in the exchange rate. Such transaction exposures arise whenever a business has foreign currency denominated receipt and payment. The risk is an adverse movement of the exchange rate from the time the transaction is budgeted till the time the exposure is extinguished by sale or purchase of the foreign currency against the domestic currency.

TRANSLATION EXPOSURE

Translation exposure is the exposure that arises from the need to convert values of assets and liabilities denominated in a foreign currency, into the domestic currency. Any exposure arising out of exchange rate movement and resultant change in the domestic-currency value of the deposit would classify as translation exposure. It is

potential for change in reported earnings and/or in the book value of the consolidated corporate equity accounts, as a result of change in the foreign exchange rates.

Translation exposure arises from the need to "translate" foreign currency assets or liabilities into the home currency for the purpose of finalizing the accounts for any given period. A typical example of translation exposure is the treatment of foreign currency borrowings. Consider that a company has borrowed dollars to finance the import of capital goods worth Rs 10000. When the import materialized the exchange rate was say Rs 30 per dollar. The imported fixed asset was therefore capitalized in the books of the company for Rs 300000.

In the ordinary course and assuming no change in the exchange rate the company would have provided depreciation on the asset valued at Rs 300000 for finalizing its accounts for the year in which the asset was purchased.

If at the time of finalization of the accounts the exchange rate has moved to say Rs 35 per dollar, the dollar loan has to be translated involving translation loss of Rs50000. The book value of the asset thus becomes 350000 and consequently higher depreciation has to be provided thus reducing the net profit.

ECONOMIC EXPOSURE

An economic exposure is more a managerial concept than an accounting concept. A company can have an economic exposure to say Yen: Rupee rates even if it does not have any transaction or translation exposure in the Japanese currency. This would be the case for example, when the company's competitors are using Japanese imports. If the Yen weekends the company loses its competitiveness (vice-versa is also possible). The company's competitor uses the cheap imports and can have competitive edge over the company in terms of his cost cutting. Therefore the company's exposed to Japanese Yen in an indirect way.

OPERATING EXPOSURE

Operating exposure is defined by Alan Shapiro as “the extent to which the value of a firm stands exposed to exchange rate movements, the firm’s value being measured by the present value of its expected cash flows”. Operating exposure is a result of economic consequences. Of exchange rate movements on the value of a firm, and hence, is also known as economic exposure. Transaction and translation exposure cover the risk of the profits of the firm being affected by a movement in exchange rates. On the other hand, operating exposure describes the risk of future cash flows of a firm changing due to a change in the exchange rate.

Operating exposure has an impact on the firm's future operating revenues, future operating costs and future operating cash flows. Clearly, operating exposure has a longer-term perspective. Given the fact that the firm is valued as a going concern entity, its future revenues and costs are likely to be affected by the exchange rate

changes. In particular, it is true for all those business firms that deal in selling goods and services that are subject to foreign competition and/or uses inputs from abroad

COMPONENTS OF FOREX RISK MANAGEMENT

- **HEDGING FOREX**

If you are an international company with exposure to fluctuating foreign exchange rate risk, you can place a currency hedge (as protection) against potential adverse moves in the forex market that could decrease the value of your holdings. Speculators can hedge existing forex positions against adverse price moves by utilizing combination forex spot and forex options trading strategies

HOW TO HEDGE FOREIGN CURRENCY RISK

Before developing and implementing a foreign currency hedging strategy, we strongly suggest individuals and entities first perform a foreign currency risk management assessment to ensure that placing a foreign currency hedge is, in fact, the appropriate risk management tool that should be utilized for hedging fx risk exposure. Once a foreign currency risk management assessment has been performed and it has been determined that placing a foreign currency hedge is the appropriate action to take, you can follow the guidelines below to help show you how to hedge forex risk and develop and implement a foreign currency hedging strategy.

A) Risk Analysis: Once it has been determined that a foreign currency hedge is the proper course of action to hedge foreign currency risk exposure, one must first identify a few basic elements that are the basis for a foreign currency hedging strategy.

Identify Type(s) of Risk Exposure

Again, the types of foreign currency risk exposure will vary from entity to entity. The following items should be taken into consideration and analyzed for the purpose of risk exposure management:

(a) both real and projected foreign currency cash flows.
(b) both floating and fixed foreign interest rate receipts and payments.
(c) both real and projected hedging costs (that may already exist).

The aforementioned items should be analyzed for the purpose of identifying foreign currency risk exposure that may result from one or all of the following:

(a) cash inflow and outflow gaps (different amounts of foreign currencies received and/or paid out over a certain period of time)

(b) interest rate exposure.
(c) foreign currency hedging and interest rate hedging cash flows.

- **Identify Risk Exposure Implications**. Once the source(s) of foreign currency risk exposure have been identified, the next step is to identify and quantify the possible impact that changes in the underlying foreign currency market could have on your balance sheet. In simplest terms, identify "how much" you may be affected by your projected foreign currency risk exposure. .

- **Market Outlook.** Now that the source of foreign currency risk exposure and the possible implications have been identified, the individual or entity must next analyze the foreign currency market and make a determination of the projected price direction over the near and/or long-term future. Technical and/or fundamental analyses of the foreign currency markets are typically utilized to develop a market outlook for the future.

B) Determine Appropriate Risk Levels: Appropriate risk levels can vary greatly from one investor to another. Some investors are more aggressive than others and some prefer to take a more conservative stance.

- **Risk Tolerance Levels**. Foreign currency risk tolerance levels depend on the investor's attitudes toward risk. The foreign currency risk tolerance level is often a combination of both the investor's attitude toward risk (aggressive or conservative) as well as the quantitative level (the actual amount) that is deemed acceptable by the investor.

- **How Much Risk Exposure to Hedge**. Again, determining a hedging ratio is often determined by the investor's attitude towards risk. Each investor must decide how much forex risk exposure should be hedged and how much forex risk should be left exposed as an opportunity to profit. Foreign currency hedging is not an exact science and each investor must take all risk considerations of his business or trading activity into account when quantifying how much foreign currency risk exposure to hedge.

C) Determine Hedging Strategy: There are a number of foreign currency hedging vehicles available to investors as explained in items IV. A - E above. Keep in mind that the foreign currency hedging strategy should not only be protection against foreign currency risk exposure, but should also be a cost effective solution help you manage your foreign currency rate risk.

D) Risk Management Group Organization: Foreign currency risk management can be managed by an in-house foreign currency risk management group (if cost-effective), an in-house foreign currency risk manager or an external foreign currency risk management advisor. The management of foreign currency risk exposure will vary from

entity to entity based on the size of an entity's actual foreign currency risk exposure and the amount budgeted for either a risk manager or a risk management group.

E) Risk Management Group Oversight & Reporting

Proper oversight of the foreign currency risk manager or the foreign currency risk management group is essential to successful hedging. Managing the risk manager is actually an important part of an overall foreign currency risk management strategy.

F) EXIT THE FOREX MARKET AT PROFIT TARGETS

Limit orders, also known as profit take orders, allow Forex traders to exit the Forex market at pre-determined profit targets. If you are short (sold) a currency pair, the system will only allow you to place a limit order below the current market price because this is the profit zone. Similarly, if you are long (bought) the currency pair, the system will only allow you to place a limit order above the current market price. Limit orders help create a disciplined trading methodology and make it possible for traders to walk away from the computer without continuously monitoring the market.

Portfolio diversification

Portfolio diversification consists of an investment strategy which basically spreads risk among a number of different types of investments.

The idea behind this strategy has to do with the fact that if you hold all of your investments in similar securities such as stocks and bonds in your local currency, then your portfolio will mirror the performance of just those two markets. Nevertheless, if both markets suffer from a downturn, so too will your portfolio’s value since no hedging investments were made.

Currency diversification

Alternatively, consider the impact of currency diversification if a portion of the portfolio had instead been invested in assets denominated in a foreign currency, say Swiss Francs for example.

In this case, the performance of the Swiss currency and its asset market relative to your local currency and markets might have at least partially offset portfolio losses that were taken your local stock and bond market.

Adding a Foreign Currency to the Portfolio

Adding a foreign exchange component to a portfolio by investing in foreign currency denominated assets might be something to consider in today's world financial environment.

Depending on the objectives of the investor, assets in a number of different currencies could be added to the portfolio to add diversification and balance. As another option, if all asset investments needed to be in U.S. Dollar denominated investments, the cash portion of the portfolio could be at least partially exchanged for a different currency, perhaps one with a higher interest rate.

Currencies could also be considered as an investment in the stock of a nation. A country which is experiencing growth and abundance will in most cases have a strong currency, while a country which is marginal economically will tend to have a weaker currency.

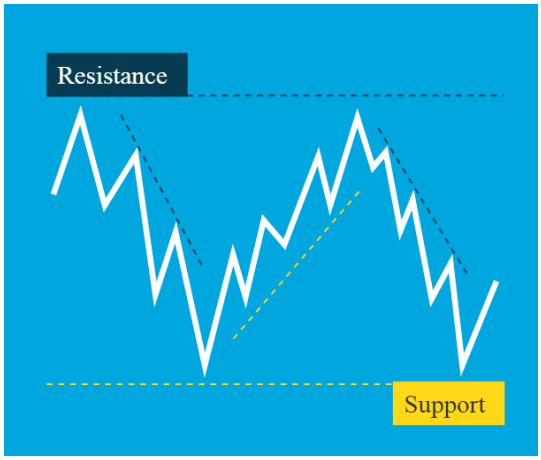
Technical Indicators

I. Support and Resistance

Support occurs when falling prices stop, change direction, and begin to rise. Support is often viewed as a "floor" which is supporting, or holding up, prices.

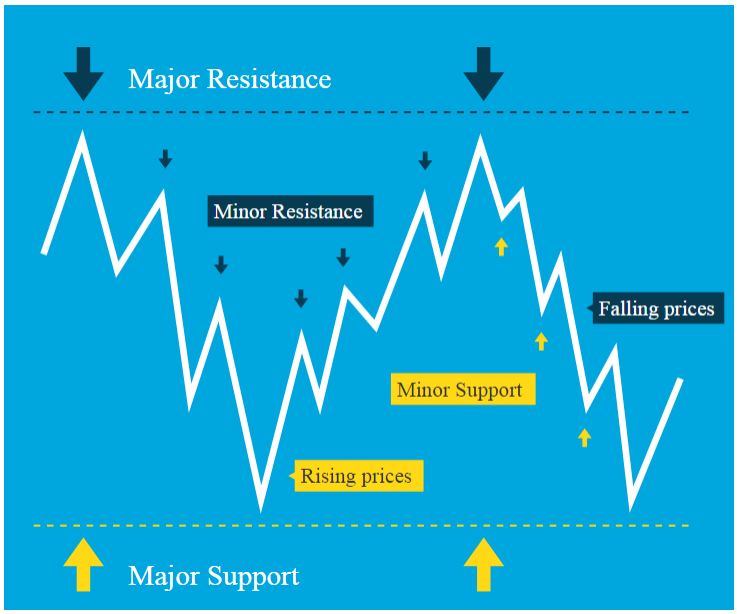
Resistance is a price level where raising prices stop, change direction, and begin to fall. Resistance is often viewed as a "ceiling" keeping prices from rising higher.

If price breaks support or resistance, the price often continues to the next level of support or resistance. Support and resistance levels are not always exact; they are usually a zone covering a small range of prices so levels can be breached, or pierced, without necessarily being broken. As a result, support/resistance levels help identify possible points where price may change directions.



Major vs. Minor Resistance/Support

Minor resistance or support temporarily delays rising or falling prices within a larger market trend while major resistance or support altogether stops either rising or falling prices and the larger market trend changes direction. Minor price resistance/support is an artificial horizontal line representing an area, which previously served as price support or resistance, and has now transformed to the other. For example, if it the price was previously a support level, it is now a resistance level



II. Moving Average

Moving Average is a mathematical result that is calculated by averaging a number of past data points. In other words, a set of numbers, or prices in the case of financial instruments, are added together and then divided by the number of prices in the set. For example, to calculate a basic 10-day moving average you would add up the closing prices from the past 10 days and then divide the result by 10. Once determined, the resulting average is then plotted onto a chart in order to allow traders to look at smoothed data rather than focusing on the day-to-day price fluctuations that are present in all financial markets.

III. MACD

MACD stands for Moving Average Convergence and Divergence. MACD is trend following momentum indicator which shows relationship between 2 moving averages.

The key components are as follows:

(a) MACD line [White line] – 12 day minus 26 day exponential moving average is default setting

(b) A Signal line [Red line] – Default setting is 9 day Exponential Moving Average (EMA)

(c) Histogram – Represents the difference between the MACD line and signal line.

IV. Stochastic Oscillator

The stochastic oscillator is another well-known momentum indicator used in technical analysis. The idea behind this indicator is that the closing prices should predominantly close in the same direction as the prevailing trend. The stochastic oscillator generally uses the past 14 trading days in its calculations, but as with any indicator, can be adjusted by traders to meet their needs.

V. Bollinger Bands

Bollinger Bands a type of statistical chart characterizing the prices and volatility over time of a financial instrument or commodity. The purpose of Bollinger Bands is to provide a relative definition of high and low prices of a market. By definition, prices are high at the upper band and low at the lower band.

VI. Ichimoku Kinko Hyo

Ichimoku Kinko Hyo, which translates to "Equilibrium chart at a glance". Ichimoku utilizes five separate components, they are not to be used individually, when making trading decisions, but rather used together to form an integrated "whole" picture of price action that can be gleaned "at a glance". Thus, a simple look at an Ichimoku chart should provide the Ichimoku practitioner with a nearly immediate understanding of sentiment, momentum and strength of trend.

(a) Tenan-sen

The tenkan-sen is calculated by adding the highest high and the highest low over the past nine periods and then dividing the result by two. The resulting line represents a key support and resistance level, as well as a signal line for reversals.

(b) Kijun-sen

The kijun-sen is calculated by adding the highest high and the lowest low over the past 26 periods and dividing the result by two. The resulting line represents a key support and resistance level, a confirmation of a trend change, and can be used as a trailing stop-loss point.

(c) Senkou Span A

The senkou span A is calculated by adding the tenkan-sen and the kijun-sen, dividing the result by two, and then plotting the result 26 periods ahead. The resulting line forms one edge of the kumo - or cloud - that's used to identify future areas of support and resistance.

(d) Senkou Span B

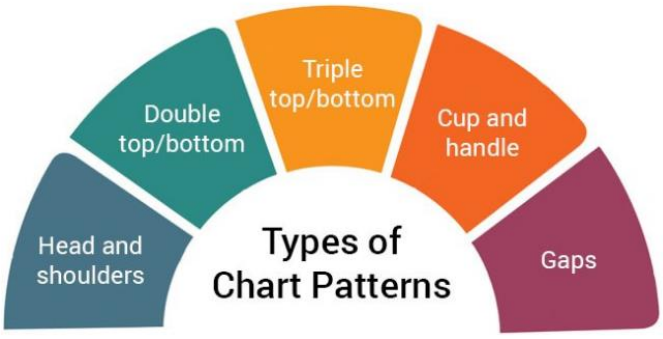
The senkou span B is calculated by adding the highest high and the lowest low over the past 52 periods, dividing it by two, and then plotting the result 26 periods ahead. The resulting line forms the other edge of the kumo that's used to identify future areas of support and resistance.

(e) Chickou Span

The chickou span is the current period's closing price plotted 26 days back on the chart. This line is used to show possible areas of support and resistance.

Chart Patterns

A chart pattern or price pattern is a pattern within a chart when prices are graphed. In stock and commodity markets trading, chart pattern studies play a large role during technical analysis. When data is plotted there is usually a pattern which naturally occurs and repeats over a period. Chart patterns are used as either reversal or continuation signals.



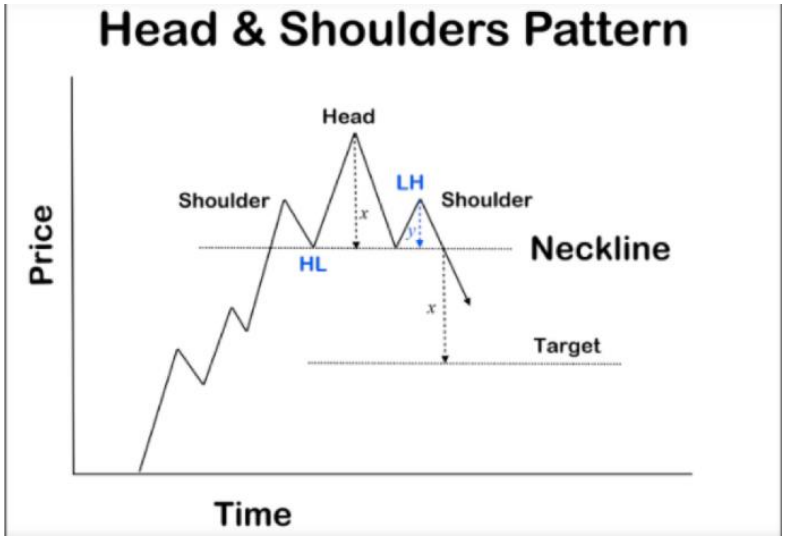
I. Head and shoulders

There are two types of head and shoulders charts.

This chart is quite easy to identify. In a head and shoulders top chart, there are three peaks. The central peak is significantly higher than the peaks on the right and left. A ‘neckline’ connects the low points in the chart and act as a support level.

In case of a head and shoulders bottom chart, the central peak is lower than the ‘shoulder’ peaks and the neckline acts as a resistance level.

This is known as a reversal pattern since it indicates a price reversal after the trend is completed. Traders watch out for the breakout level to identify when to buy or sell the stock.

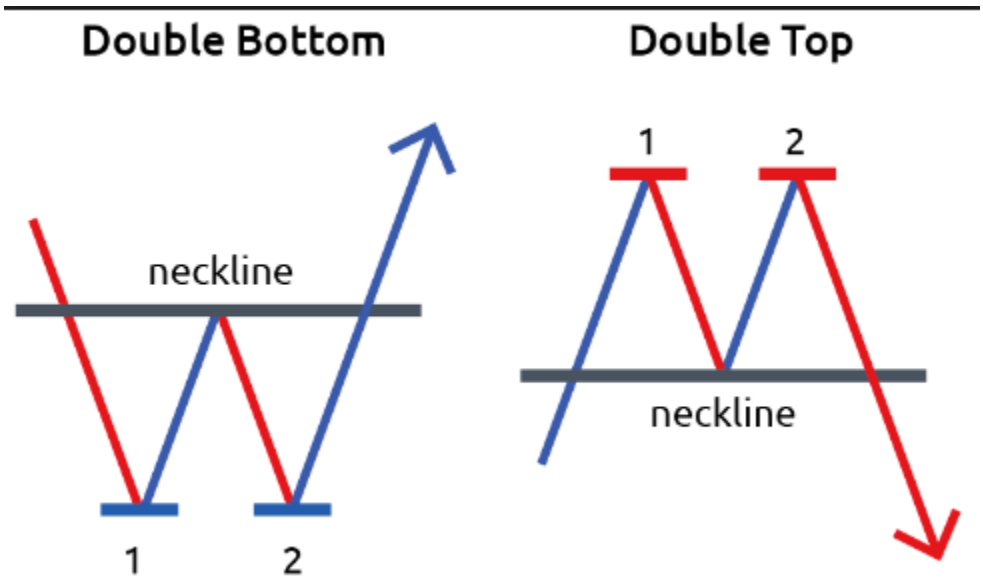


II. Double top/bottom

The double top/bottom is another trend reversal chart used by technical analysts. This chart is recognizable by the fact that the stock price reaches the same level at two different times without breaking the level.

In case of a double top pattern, the price hits the same resistance level on two occasions. In case of a double bottom pattern, it hits the same support level.

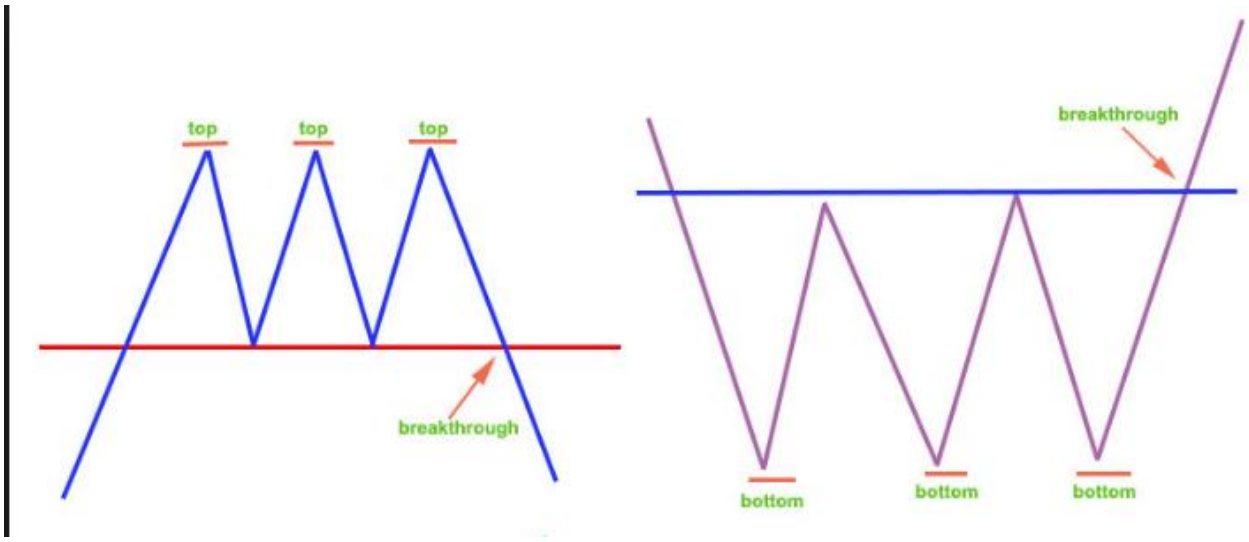
Following this, a trend reversal occurs immediately or over the long term.



III. Triple top/bottom

A triple top/bottom chart is similar to a double top/bottom chart. Except that instead of two highs/lows, there are three highs/lows on this chart. That is, in a triple top chart, the stock price hits the same resistance level at three different points before breaking out below the support level.

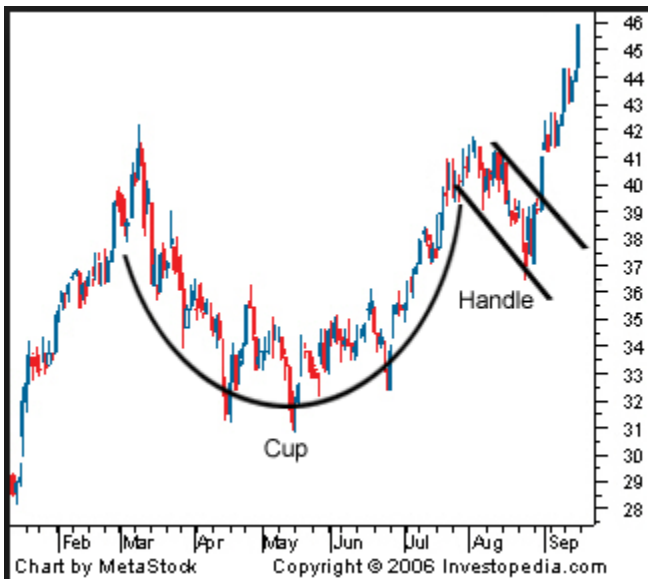
The opposite happens in a triple bottom chart. These patterns are generally formed over a period of three to six months.



IV. Cup and handle

As the name suggests, this chart is roughly in the shape of a cup and a handle. Here, the price pattern makes a curved 'U' shaped pattern. The highs on both sides of the cup are roughly at the same level.

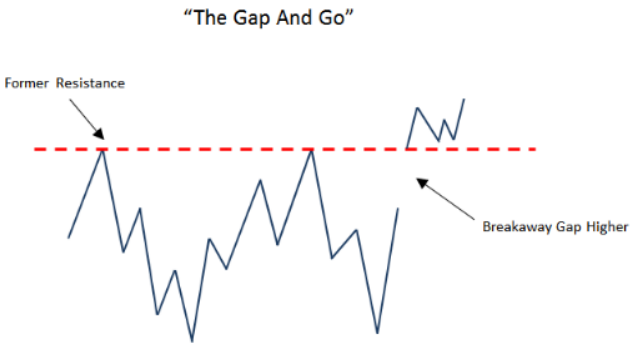
Following this, a temporary pullback occurs where the stock price may fall down slightly before it consolidates. This creates the handle portion of the pattern. This is generally followed by a big breakout above the resistance level created by the cup.



V. Gaps

Gaps occur in charts when the stock price moves significantly up (or down) between two price levels with little or no trading occurring between these two levels.

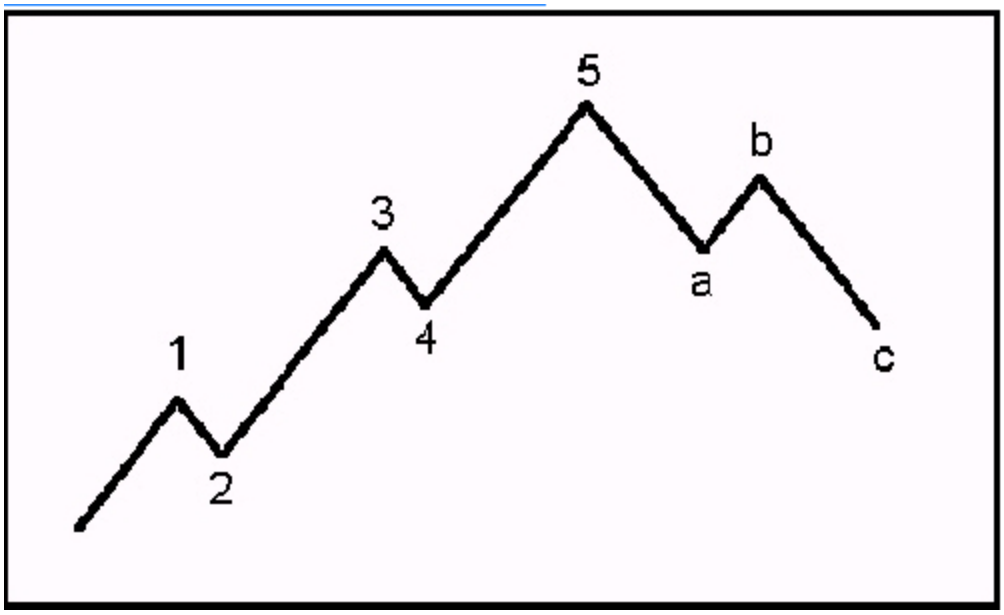
For example, if a stock closed at Rs 40 on a Monday and opened directly at Rs 55 on a Tuesday, a gap occurs on the price chart. This generally happens when any major news such as high earnings reports is announced in the market.



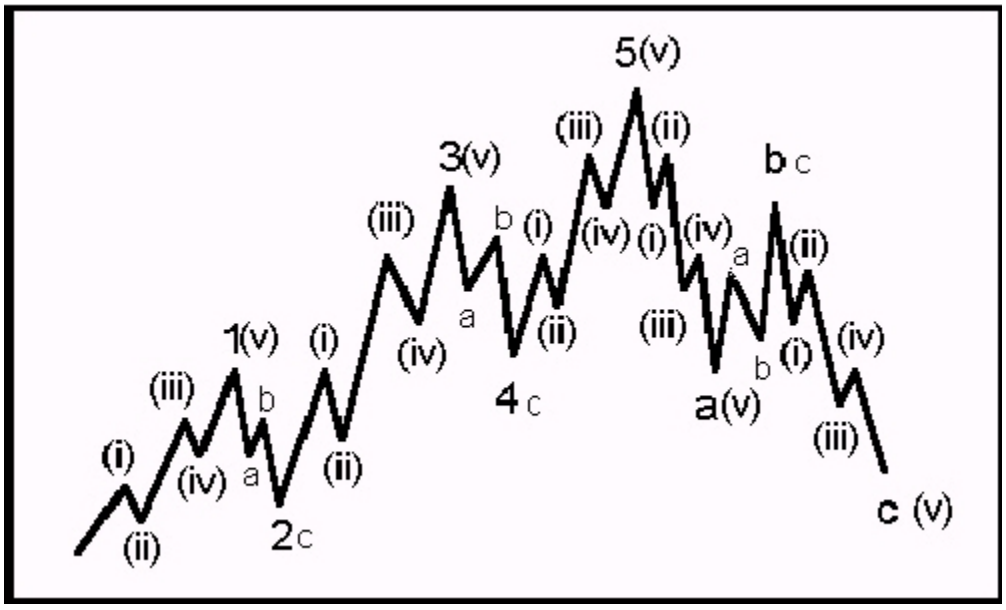
1. Elliott Wave Theory

The Elliott wave principle is a form of technical analysis that some traders use to analyze financial market cycles and forecast market trends by identifying extremes in investor psychology, highs and lows in prices, and other collective factors. Ralph Nelson Elliott (1871–1948), a professional accountant, discovered the underlying social principles and developed the analytical tools in the 1930s. He proposed that market prices unfold in specific patterns, which practitioners today call Elliott waves, or simply waves. Elliott published his theory of market behavior in the book The Wave Principle in 1938, summarized it in a series of articles in Financial World magazine in 1939, and covered it most comprehensively in his final major work, Nature's Laws: The Secret of the Universe in 1946. Elliott stated that "because man is subject to rhythmical procedure, calculations having to do with his activities can be projected far into the future with a justification and certainty heretofore unattainable."

Elliott Wave Theory interprets market actions in terms of recurrent price structures. Basically, Market cycles are composed of two major types of Wave : Impulse Wave and Corrective Wave. For every impulse wave, it can be sub-divided into 5 - wave structure (1-2-3-4-5), while for corrective wave, it can be sub-divided into 3 - wave structures (a-b-c).



Waves within Wave An important feature of Elliott Wave is that they are fractal in nature. 'Fractal' means market structure is built from similar patterns on larger or smaller scales. Therefore, we can count the wave on a long-term yearly market chart as well as short-term hourly market chart



Rules for Wave Count

Based on the market pattern, we can identify ' where we are' in term of wave count. Nevertheless, as the market pattern is relatively simplistic, there are several rules for valid counts:

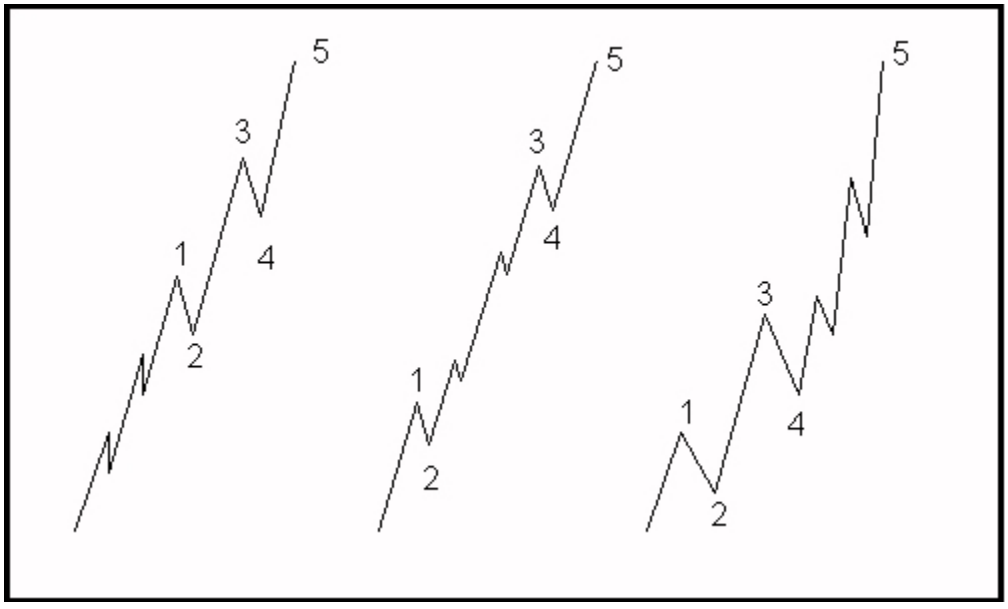
- Wave 2 should not break below the beginning of Wave 1;
- Wave 3 should not be the shortest wave among Wave 1, 3 and 5;
- Wave 4 should not overlap with Wave 1, except for wave 1, 5, a or c of a higher degree.
- Rule of Alternation: Wave 2 and 4 should unfold in two different wave forms.

I. Wave forms in Impulse Wave

There are three major types of wave form in Impulse Wave:

(a) Extended Wave

Among Wave 1, 3 and 5, only one should unfolded into extended wave. 'Extension' means the wave is elongated in nature and sub-waves are conspicuous in relation to waves of higher degree.

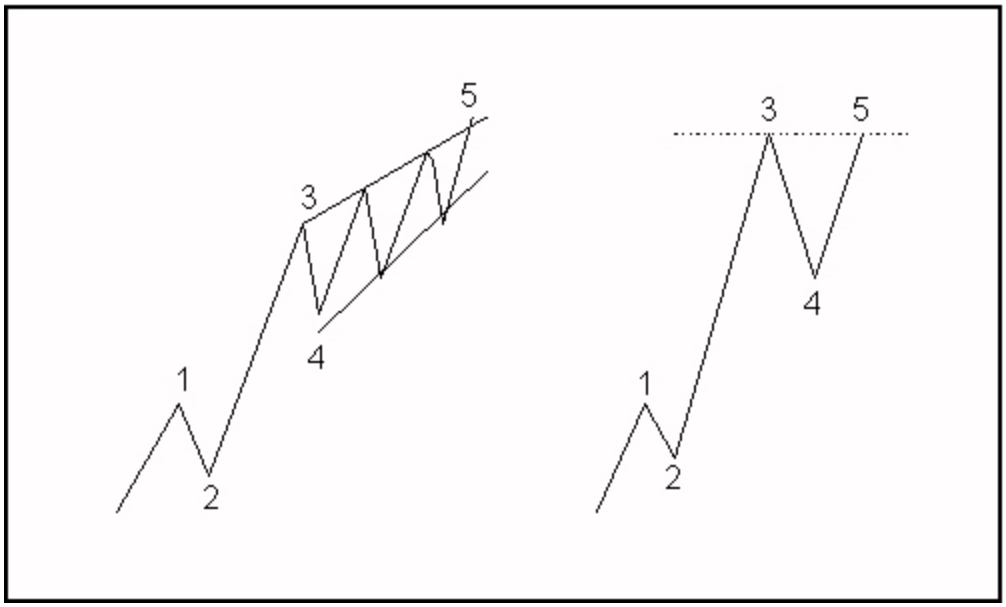


(b) Diagonal Triangle at Wave 5

Sometimes, the momentum at Wave 5 is so weak that the 2nd and 4th sub-waves overlap with each other and evolved into diagonal triangle.

(c) 5th Wave Failure

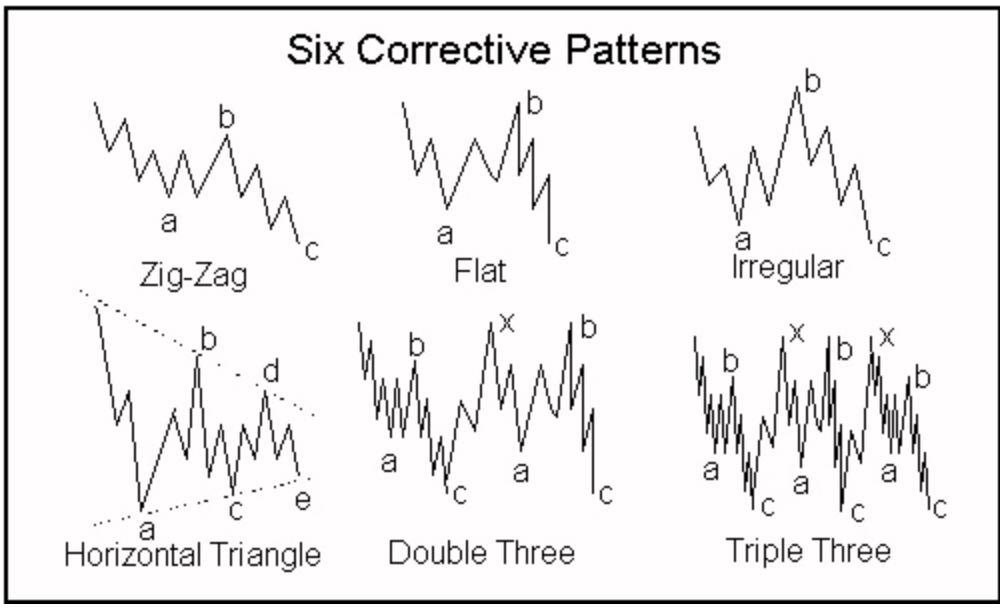
In some other circumstances, the Wave 5 is so weak than it even cannot surpass the top of the wave 3, causing a double top at the end of the trend.



II. Wave Forms in Corrective Wave

Corrective Wave forms are rather complicated, but basically we can categorize them into six major wave forms:

(a) **Zig-Zag:** abc pattern composed of 5-3-5 sub-wave structure.
(b) **Flat**: abc pattern composed of 3-3-5 sub-wave structure, with b equals a.
(c) **Irregular**: abc pattern composed of 3-3-5 sub-wave structure, with b longer than a.
(d) **Horizontal Triangle:** 5-wave triangular pattern composed of 3-3-3-3-3 sub-wave structure.
(e) **Double Three:** abcxabc pattern composed of any two from above, linked by x wave.
(f) **Triple Three:** abcxabcxabc pattern composed of any three from above, linked by two x waves.



The attractiveness of Elliott Wave Analysis is: Three impulse wave forms and six corrective wave forms are conclusive. All we have to do is to identify which wave form is going to unfold in order to predict future market actions, however knowledge of market historical wave patterns and experiences in wave count are of paramount importance.

Dealing with Pain/Loss

There's really no way around it. You're going to lose money at some point if you invest in stocks. It's bound to happen sooner or later. In fact, it might have happened already and you didn't even realize it because losses can take several different forms.

Capital Lost

In simplest and most painful form, you buy a stock then watch the price go down and stay down. At some point, you decide to end the pain and sell it. This type of loss is called a capital loss because it involves an actual dollar amount.

You can use a capital loss to offset profits, called capital gains for tax purposes. But beyond that, they're just a painful investing lesson.

Lost Opportunities

Another type of loss is less painful but still very real. You might have bought $10,000 of a xyz stock and one year later, after some ups and downs, the stock is very close to what you paid for it.

You might be tempted to tell yourself, "Well, at least I didn’t lose anything." But that's not true. You tied up $10,000 of your money for a year and you received nothing in return. If you had bought a bank CD, it would have earned you at least a little bit of interest.

Every stock purchase begins with a measurement against a risk-free investment such as a U.S. Treasury note. Ask yourself how much more could you earn purchasing a particular stock with some additional risk compared to what you could have earned on a note with no risk.

When a stock goes nowhere or doesn’t even match the risk-free return of a bond, you're losing money. You lost the opportunity to invest your money in something that would have earned you a positive return over and above the risk-free return—and that is a true loss.

Missed Profit Losses

This type of loss results when you watch a stock make a significant run-up then fall back, something that can happen with more volatile stocks. Not many people are successful at calling the top or bottom of a market or a stock. You might feel that the money you could have made is lost money—money you would have had if you had just sold at the top.

Many investors sit tight and hope the stock will “recover” and regain the high, but that might never happen. Even if it does, too many investors hold on hoping for even greater profits only to see the stock retreat again. The best cure for this type of loss is to be happy with a reasonable profit and don’t try to squeeze every penny out of a stock, risking a retreat and a missed profit loss.

Dealing with It

No one wants to suffer a loss of any kind, but don’t let your ego get in the way of making the right decision when it happens. The best course of action is often to cut your losses and move on to the next deal. But there are other ways to take a deep breath and move forward, too.

Review the decisions you made with a cold eye after some time has passed. Could you have done anything differently? Would you have lost less or perhaps nothing at all if you had acted differently? Try to learn from the experience.

Here are seven steps successful traders take after a loss to become emotionally stronger and more disciplined:

1. Accept responsibility: You made the loss; be sure to own it. Don't brush it aside, hide from it, or blame the "smart money" for your loss. When you take ownership, you control your trading — and that's exactly where you want to be.

2. Stop trading: Take a break to figure out what went wrong. Assess what happened by reviewing events carefully. Think about where you fell short. For example, did you take too much risk? Was the trade well-planned? Were you mentally sharp, or did you hold a losing trade hoping to avoid a loss?

3. Have a plan: Make a detailed action plan for future trades. The ingredients of your plan should include things you will do differently (e.g., setting and honoring a stop) and also what you will no longer do (e.g., holding a loser, hoping it will return to break-even).

4. Make a better plan: Can you identify factors from this trade that could be used to reverse the trade position? Good traders will take the loss as a stop-out and wait for the next opportunity. Better traders will reverse their trade — if market conditions permit — and make up not only for the initial loss but add profits to their bottom line.

Most trades that go strongly against us do so because of detectable reasons. Can you identify key market actions (e.g., changes in momentum, volume levels, price activity) that you can recognize and profit from? This will give you clear criteria for a trade not working and a fresh, new edge. Equipped like this, you are far less likely to suffer large losses in the futu

5. Put your loss in perspective: You are more than your trades. You have other roles that are important to you and others. One trading loss — even a large one, doesn't define your worth. Getting perspective on your life when the chips are down helps restore balance so you can take steps to turn your trading around.

6. Be inspired: Use this loss as motivation for learning and develop your skills for better trading. The best professional athletes become excited when they discover they have a weakness in their game. They use the weakness as a catalyst to improve.

7. Get back in the game: Once you've done the recovery work, trade again. You're mentally stronger and better-prepared than you were. Let the loss go and put your good intentions into practice.

Trader plan and psychology

Many ways succeed and only few to fail, however can come quickly if you don't have proper plan and you need to stick to it. Initially maintain a trading journal and include points as name, start price, end price, stop loss and reason (profit/ loss and what get you to do this trade)

Success full trader:

- Create a trading plan
- Follow your trading plan
- Apply proper risk management
- Be discipline

Trading Psychology Tips

- Stick to a trading plan
- Don't move your stop loss
- After a big profitable day – stop trading
- Having a bad day? Stop trading.
- Check the Economic Calendar
- Treat your trading account as if your livelihood
- Don't follow your Friends or Rumors