



5 Tricks of Trend Trading

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Guiding Principles of this eBook

1. I can teach you, in one hour of chatting together here, to identify trends.
2. You can find ways, when you identify trends, to earn consistent trading profits.

Definition of a Trend

A trend is the general, dominant direction of a market or an asset. If we say that the trend on the EUR/USD is up on the daily chart, then we are saying that the EUR/USD has been moving upward and is more likely than not to continue to do so.

Additional Resources

The eBook you are reading right now is, hopefully, just the beginning of our discussion on this topic. To encourage you to explore the subject more deeply, I've provided some additional resources.

Investopedia has a good definition and section on trend trading here:

<http://www.investopedia.com/terms/t/trendtrading.asp>

A discussion about this eBook can be found at Forex Factory:

<http://www.forexfactory.com/forexforum/showthread.php?p=129416#post129416>

And a discussion can be found at the new FXStreet.com Forum:

<http://www.fxstreet.com/forum/showthread.php?t=44>

An audio podcast, and a video-cast of this eBook, including my views about the USD trend right now, can be found at:

http://www.piptopia.com/2006/10/30/5_secrets_of_trend_trading.php#more

Richard Dennis' rules for trend trading can be found here:

<http://www.robbocker.com/woodchuck/training/turtles/turtlerules.pdf>

My basic trend following system can be found here:

http://www.robbocker.com/books/5_13_62.pdf

Trend Trading has a Long History

Richard Dennis, the guy I mentioned above, is not the inventor of trend-trading, but he certainly made it famous. A famous trader named John Henry became so rich he was able to buy his favorite baseball team, the Boston Red Sox. I traded the 5/13/62 rules for 18 months very profitably.

Do the all these trend rules work? Sure they do. People have made hundreds of millions of dollars following the rules. But are there other ways to trade with the trend besides the turtles, or my EMA crossover system? Of course!

Or you can do a search for “Trend Trading” on Forex Factory (www.forexfactory.com), which will have a zillion discussions going on about the identification and proper trading of trends. The point is that finding a set of rules for trading with a trend is easy. That’s the easy part! The turtle rules, or my moving average strategy above, are both free. No charge. That should be your favorite price.

But once you get your greedy little mittens on the rules, what’s next? If the rules are so easy to find, then what makes the difference between a profitable trend trader and a losing one?

Read on.

The Tricks Aren't Secret at All



Everything you'll read in this eBook is probably available elsewhere. For free. But I'm going to try to incorporate the most important elements of a profitable trend trading system. I am not going to talk about entry and exit rules – you can find those in the links above, and share more ideas with each other in the forex factory forum that has been created.

But what I do share – the information below – is truly what has made the difference for me and hundreds of other traders around the world.

Trick #1: Verify First, Then Trade

Most people totally ignore me when I talk about testing. When I train people to trade, I focus most of the training on helping them do their testing. I have developed spreadsheets, methodologies, statistical models – all designed to help traders realize that they must verify that a system works before they commit to trading the system with real money.

Don't ever trade anything you've not tested first.

What does it mean to test? It means that you propose some simple rules for trading. Then you go back in time, manually or mechanically, and you find out how those proposed rules would operate over the course of hundreds of trades. That's right: hundreds of trades.

Think about it for a moment: if you are not confident about your trading, it's most likely because you have doubts about the outcome of the trades you are taking. And if you are doubtful about the outcome, then you need to do more testing until you have a better sense for what's going to happen when you open a trade.

Trick #2: Become Obsessed with One Area of Focus.

Discipline yourself to focus. Diversification is good for your portfolio. It is not good for your career.

Let's look at some examples. Think of the very best attorney or doctor that you know. Does that person specialize in one area, or does she practice law or medicine across a huge subject area? My guess is that she is known for one type of legal specialty, or as a doctor, she is a cardiologist (hearts), radiologist (treating cancer), or something else.

The highest paid professionals are specialists. Why should that be any different for you?

You are wise to diversify the investments that you can't watch closely. You don't want to commit your entire life savings to forex. You might have money saved in the equity in your home, some in a retirement account, some money in a bank savings account, and then some in a forex trading account.

But if you are going to be a forex trader for a living, then it makes sense – with respect to your currency trading, to focus on a currency pair, a system for trading that pair, and a time frame for watching that pair. If you focus on one currency pair to start, you can become as much of an expert as possible in that one area.

How does this relate to trend trading? It is the heart of the issue, it is the foundation for you to become successful as a trend trader.

Let's say that you read my 5/13/62 eBook and you decide that you're going to focus on that system. Becoming obsessed with one area of focus means that you set aside time every day to test 50 historical trades. And that you only watch one currency pair to start. And that you only watch one time frame. And you become an expert in that system, on that one currency pair, in that one time frame. If you look at 1,000 trades with those parameters, you are going to become an expert.

If you become an expert, you are going to trade profitably.

Trick #3: Different Trends on Different Time Frames

The EUR/USD can be trending upwards on the daily chart, but on the 5 minute, it can be trending downward.

Really? Is that possible? Absolutely!

Think about it for a moment – if you have a long term, daily, dominant move upwards on the EUR/USD, it's possible that in the shorter term we could see a movement in the opposite direction. So remember, if you want to be a trend trader, you can choose to follow the trend on a variety of different time frames.

If you have a full time job, you might look at trends on the daily and weekly charts. These trends take much longer to start and finish – but they are worth a lot of pips – even more than 1,000 pips.

If you are able to trade during the day, you might look at the very short term charts. I have been testing a new trend following system that works even on the 1 minute charts. I don't trade from the 1 minute charts (at least right now) but I would be willing to follow a trend on just about any time frame. The point is that each time frame can have its own trend.

Trick #4: Trend Trading Requires Courage & Money Smarts

If you want to become a trend-trader, you are going for the big moves. You are NOT going to be trying to get 10 pips on each trade (I talk about that here: <http://www.robbooker.com/books/Strategy10.pdf>). You're going to want to get 50 to 500, and maybe even many more pips, when you are trend trading.

To do this you are going to have to commit yourself to a patient process of waiting for a trend to develop, and then to stay in your trades. Most currency traders are focused on the short term – and there are lots of jumps up and down in the short term. Have you ever noticed that after a major economic release, a currency pair will initially move in the direction you expect it to go, but then all of the sudden it will move the opposite way?

Take, for instance, a Non Farm Payroll report where the number is low, or in other words, "bad" for the US Dollar. And then, all of the sudden, the US Dollar grows stronger anyway! This infuriates traders. I get at least 50 emails every time a major economic report comes out, with questions just like this. It's a great question. And the answer is often that the trend was more dominant than the news.

Let's take the example of a recent downtrend in the GBP/USD on the 1 hour chart. Move on to the next page and let's see the example:



Figure 4.1. *The GBP/USD, on the 1 hour chart, temporarily spiked upwards after a Non Farm Payroll report. But soon after, the major trend continued.*

As you can see in the chart, a small spike upward really didn't mean anything. It was a temporary moment of market chaos after the U.S. Non Farm Payroll report was released. Do you see how short term news does not **necessarily** have a major impact on the trend? I say "necessarily" because I want you to know that it's possible that the Non Farm Payroll could have started a reversal of the trend. But it did not. Once we saw that the previous trend was going to continue, then we could confidently trade in the direction of the dominant trend.

In the case of the chart above, the smart money stayed with the trend.

The other element, besides courage, is what I like to call "money smarts." This means that as a trend trader, you're going to keep your trade size small. To ride out a trend, as in the example in Figure 4.1, you have to be able to take a big temporary loss in the GBP/USD before it starts trending in the downward direction again.

Does that make sense? As a trend trader, you're going to have to watch a currency pair move against you, and you are going to not only require the courage to stay in the trade, but an account balance that can withstand the loss.

Have you ever made a great trade, but you couldn't stay in it long enough because you took a big loss? Meaning, you made the right call on the direction, but you got stopped out before the big move? The answer to this is that you traded too large. Scale back your position size if you're going to ride the trend.

Trick #5: TV People are Wrong

Watch out for the news. Be wary of commentators on CNBC or Bloomberg that say things like "the trend on the USD is certainly up," or "traders would be wise to scale back their long dollar positions because the trend is going to be down." These people don't trade your account. They have no idea what chart time frame you are watching or what trading system you follow.

In the past 4 years, I have worked with approximately 1,060 traders from around the world (as of October 31, 2006). Most of them, at one time or another, were scared out of a really good trade because they heard something on television, received an email, or were influenced by a friend.

If you watch TV and you see some windbag get fanatical about one trade or another, then run away from your television as fast as you can. It is better to smash your television than it is to base your trade ideas on what you learn there. Keep in mind that I didn't say that you should NOT watch business news. I just said that we need to be careful about what we allow ourselves to listen to.

Conclusion

You can get rules for entering and exiting trend trades from all over the Web. They're easy to find. What makes the difference in trend trading is doing the little things right – the stuff that most traders overlook. For me, it's all about discipline in your testing, in your trading, in your money management.

I try to give a lot of material away for free. I hope you'll stop by the Web site, and I hope that you'll stay in touch. Remember, the free audio and video versions of this ebook are available on my blog, at this address:

http://www.piptopia.com/2006/10/30/5_secrets_of_trend_trading.php#more

Keep in touch!

Rob Booker