ThinkMarkets®

INTERMEDIATE TRADING GUIDE

MARKET TRENDS

INTRODUCTION TO TECHNICAL ANALYSIS

TRENDS SEEM EASY TO SPOT IN TEXTBOOK EXAMPLES, BUT CAN CONFUSE EVEN SEASONED TRADERS WHEN FACED WITH A LIVE PRICE CHART.

Table of Contents

RISK WARNING 2

WHAT IS TECHNICAL ANALYSIS? 3

TECHNICAL vs FUNDAMENTAL ANALYSIS: 3

TREND COMPONENTS 4

- Peaks & Troughs 4
- Phases 5

TREND IDENTIFICATION: 6

- Higher Highs (HH) and Higher Lows (LL) 6
- Moving Averages 7
- Trendlines 8

TREND REVERSALS: 9

- Identifying *Potential* Reversals 9

TRENDS WITHIN TRENDS: 10

- Primary, Secondary and Minor Trends 10
- Trend Trading with multiple timeframes 12
- Summary 13

REDUCE YOUR LEARNING CURVE: 13

Risk Warning

Risk Warning: Derivatives including spread betting, CFD & Forex trading are leveraged products and as such carry a high level of risk to your capital, which can result in losses greater than your initial deposit. These products may not be suitable for all investors. Ensure you fully understand all risks involved and seek independent advice if necessary. Refer to the section titled "Significant Risks" in our Product Disclosure Statement, where applicable, which also includes risks associated with the use of third parties and software plugins. Spread betting and CFD trading are currently exempt from UK stamp duty. Spread betting is also exempt from UK Capital Gains Tax. Tax laws are subject to change and are dependent upon individual circumstances. CFD investors do not own, or have any rights to, the underlying assets. ThinkMarkets is a trading name of both TF Global Markets (UK) Ltd and TF Global Markets (Aust) Pty Ltd. TF Global Markets (UK) Ltd is authorised and regulated by the Financial Conduct Authority (FCA) under FRN 629628. Registered address: 2 Copthall Avenue, London EC2R 7DA, United Kingdom. TF Global Markets (Aust) Pty Ltd is registered with the Australian Securities and investments Commission under ABN 69 158 361 561 and is the holder of Australian Financial Services Licence 424700. Financial products shown on our website(s) are issued by either TF Global Markets (UK) Ltd or TF Global Markets (Aust) Pty Ltd. A Product Disclosure Statement (PDS) for the financial products offered by TF Global Markets (Aust) Pty Ltd and Financial Services guide (FSG) is available here. You should consider the PDS when deciding whether to acquire one of our financial products offered by TF Global Markets (Aust) Pty Ltd. Any analysis, opinion, commentary, education or research-based material on our website(s) is for information and educational purposes only and is not, in any circumstances, intended to be an offer, recommendation or solicitation to transact in any financial instrument.

Items that are indicated as FREE are available without any terms and conditions, with the exception of any promotional offers that have terms and conditions attached.

©2016 ThinkMarkets

Thank you for downloading this Trading Guide. This is the first of a 4-part series to introduce you to Technical Analysis

Part 1: Trends
Part 2: High Probability Support & Resistance
Part 3: Chart Patterns Trading
Part 4: TA Techniques Combined

Please view the recorded webinar which accompanies this trading guide. We discuss both the theory and the practical methods described in this document and finish off by looking at real-world charts and questions.

Trends
By Matt Simpson
Copyright @ 2015 TF GLOBAL MARKETS (AUST) PTY LTD
All Rights Reserved

WHAT IS TECHNICAL ANALYSIS?

Technical Analysis is the study of historical price data in order to forecast or profit from future price movements. As the markets are driven by supply and demand, fear and greed, we can look at price collectively as the ongoing argument between market participants' opinion of future price. Taking this view that market prices contain all opinions of future price, a Technical Analyst assumes that price discounts everything, therefore all the analyst needs to read is the price chart itself.

Technical Analysis allows a trader to:
- Identify trends
- Anticipate a change in trend
- Confirm a change in trend (reversal)
- Time a trade entry
- Determine a trade exit
- Know when the analysis is incorrect

If your objective is to make money then we must spot a trend early enough to enter before it ends, but at the same time as safely as possible. This sounds easier than it actually is.

A trader is faced with two options: When to enter a trade; when to exit a trade. When exiting, the trader must make a decision as to when they will exit in both profit and loss.

TECHNICAL vs FUNDAMENTAL ANALYSIS

If Fundamental Analysts looks at the reason behind past or potential market moves, then Technical Analysts look at the effect of market moves.

They both agree on the principle of supply and demand. However a Technical Analyst does not need the reason behind the change in supply and demand to see that a change has in fact taken place – as they can visually see this change in the form of trends on a price chart.

We could look at the comparison as price versus value:
- Technical Analysts look at price
- Fundamental Analysts look at value

Some analysts choose to use both forms of analysis in tandem, whereas others (like myself) decide to specialize in one or the other. There is no right or wrong answer as to which you should choose, as long as you are comfortable using a particular method and can make an objective trading plan using your chosen method/s.

TREND COMPONENTS

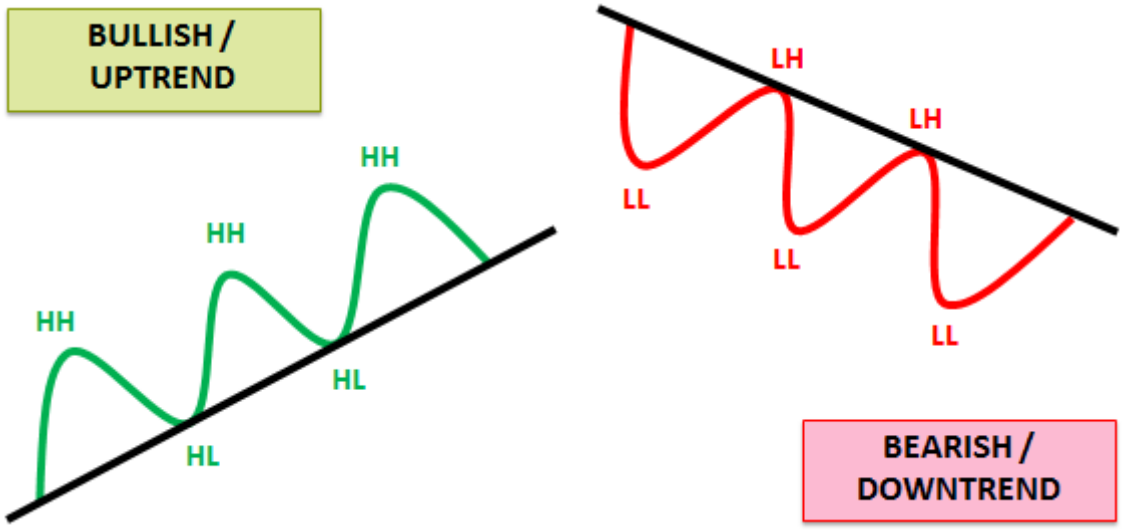
Prices do not move in straight lines – instead they oscillate forming peaks and troughs along the way. The true definition of a trend is the formation of higher highs and higher lows (for an uptrend) or lower lows and lower highs (in a downtrend).

By breaking trends down into their core components we can more easily build a framework and make sure you are all on the same page before going to live charts.

Peaks & Troughs

Trends are formed by a succession of peaks and troughs, which when they rise or fall help us define our trend. We are comparing the peaks to the peaks and the troughs to the troughs to assess the direction of the trend as either bullish (rising) or bearish (declining).

If you identify several peaks and troughs which are not covering new ground (oscillating sideways) then the market is not considered to be trending.



Bullish Trend: Defined by a series of higher highs (HH) and higher lows (HL)

Bearish Trend: Defined by a series of Lower Highs (LH) and Lower Lows (LL)

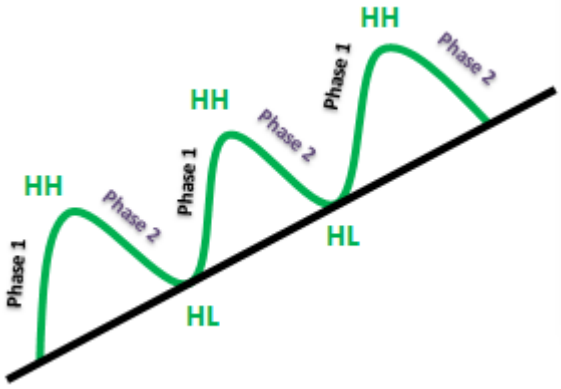
If HH/HL or LH/LL are not being formed then price is not considered to be trending!

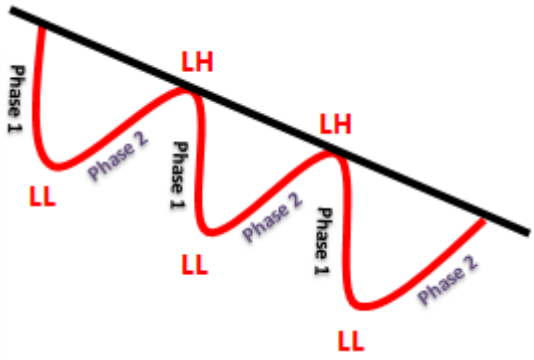
Phases

Throughout any trend you will see counter-trend moves which vary in size, which can make the trend very difficult to identify or follow at times.

Peaks and troughs are connected by Phases

- Phase 1 is always in line with trend (Impulsive)
- Phase 2 is always counter-trend (called corrections or retracements)
- Phase 1 and 2 will always interchange
- You can look at the phases of a trend like breathing (you always exhale after inhaling).
- Phase 1 will always be longer (in price movement) than phase 2
- Time is not a factor, as either phase 1 or 2 can last longer in time.





Phase 1:

- In line with the trend
- Is a larger move than phase 2
- Usually lasts longer in terms of time, but not always
- The steeper the angle of phase one, the more bullish/bearish the phase of the trend is assumed to be
- Swing highs/lows do not overlap very much during a strong trend

Phase 2:

- Countertrend (against the dominant trend)
- Is a smaller move than phase 1
- Usually is shorter in time than phase 1, but not always
- Can be messy (lots of swing overlaps, whipsaws)
- Moving averages can become useless

Phases On a Real Chart

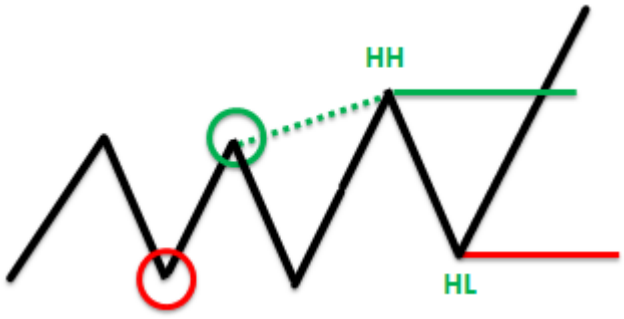
- Whilst the theory is sound spotting this on a real chart in real-time is a subjective process, and much easier to do in hindsight
- For this reason phases are good to prevent you from jumping in to a trend too late during a cycle but are much harder to try and catch the start of 'phase 1'
- To help with this you should use additional forms of analysis such as Support & Resistance or Candlesticks, which will be discussed in the subsequent trading guides.

TREND IDENTIFICATION

We will look at the popular methods we can use to locate trends – these are flexible methods which can be combined for extra confidence in a trend and provide a structure which allows you to better understand the trend strength and direction. I'll provide simplistic pictures of trends to make sure you grasp the concept, however rest assured trends are never this pretty in real life

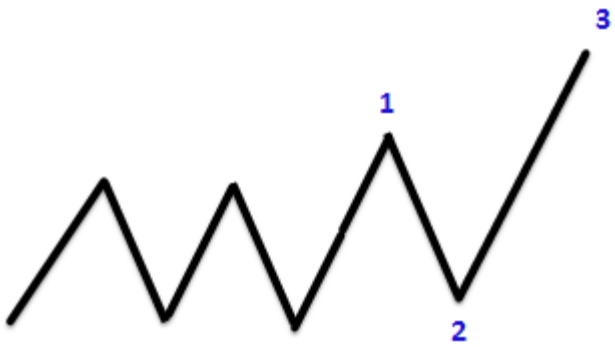
The 3 most commonly used methods to identify, and measure the strength of a trend are:
- Higher High and Higher Lows
- Trendlines
- Moving Average

Higher Highs (HH) and Higher Lows (LL)



- Until HH forms we are in a sideways market, however this does not confirm a trend. Some traders may anticipate this as a breakout only to see price return within the channel.
- We also need a HL to form before we can suspect a trend.
- To confirm the HL we need price to then go above HH

- An easier way to visualize this is the *1-2-3* method
- Personally I only trade on the 3rd move, in the same direction of the suspected trend
- This is why trading is more of a waiting game
- The trend can still reverse at any time, but by waiting for a HH and HL to form we have more confidence of buying power



Moving Averages

Moving averages smooth out the data to make identifying trends easier. By using combinations of moving averages and looking at where price is trading in relation to its own moving average we can quickly identify the direction and strength of the underlying trend.

Where is price trading in relation to the MA's?

If price is accelerating away form an MA then this displays an increase in momentum, and more confidence can be gained from the move. However be warned that price always has to return to it's own moving average at some point.

If price moves beneath a moving average (in an uptrend) then this can be seen as a sign of weakness.

Are they in order/Fanning?

To the left we can see how the 20 is above the 50, which is above the 200. At times they were also 'fanning' which means long, medium and short-term momentum is increasing and provides greater confidence in the trend.

How aggressive is the slope of the MA's

A shallow slop displays less momentum in a price movemeent whereas a steeper slope displays more aggressive momentum.

In these examples I have used 20, 50 and 200 eMA (exponential moving averages) mainly because they are popular, but also because they are good at identifying short, medium and long-term trends.

Some traders will only trade when the eMA's are 'in order' and ignore trades where price is between the 50 and 200eMA.

When combined with LH and LLs you can more easily identify higher probability trends and stay flat when there is too much confusion between the techniques.

Trendlines

Trendlines are another simple method used to identify trends

I define as a trendline as follows:
- Can be connected with a straight line
- Usually consists of a minimum of either 3 peaks or 3 troughs
- The line must be uninterrupted by any other price action trading through it

The more touches a trendline has the more reliable and significant it is considered to be, and you can extrapolate them (project into the future) for potential price direction, or support/resistance areas.

Should price break though this line the trendline is invalidated and the trend is deemed to be over.
A break of a trendline can be a warning of a trend reversal, especially if it is well established.

Whilst some traders use trendlines to trade from, I do not find them reliable enough to use in isolation as they do not generate buy or sell signals by themselves. Remember, all we are trying to do is assess the direction of price to assume it will continue. Think of trendline as using stabilisers on a bike when you start to learn to how ride.

Personally I only use trendlines to provide market direction, or use them alongside other forms of analysis such as support and resistance and price patterns to see how confident I am of a trend continuing.

The main caveat to trendlines is that by the time you have identified a trend with 3 touches, they can quite often reverse.

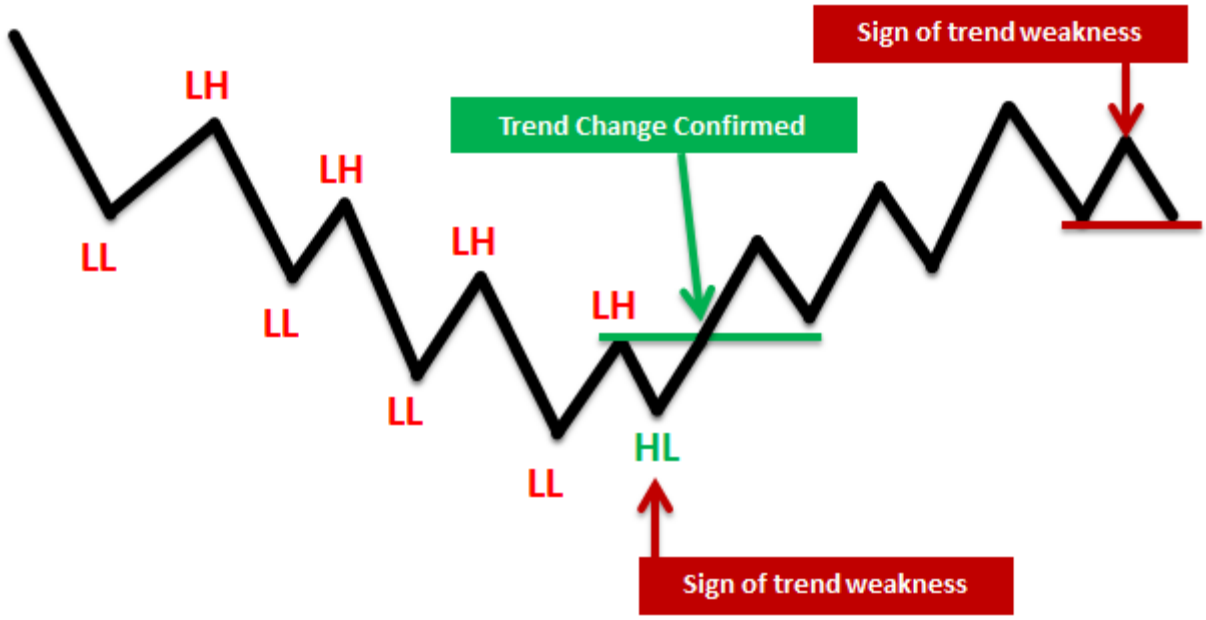
TREND REVERSALS

Identifying *Potential* Reversals

I am showing you this as a method to highlight potential weakness of a trend you are either tracking or trading - this is not for the purpose of trading reversals. Besides this is also going to be covered in more detail in part 3 – Chart Patterns…

But for those who may have already studied chart patterns you may have noticed the double bottom and double top reversal patterns at either end of the trend

- LH (Lower high) is the first clue of weakness to the trend
- The start of a new trend is the confirmation



- During the downtend we notice the potential for a HL is forming. Whilst it is not yet confirmed, as price retraces towards the previous LH we take note of the weakness and are prepared for a change in trend.
- The change in trend is confirmed when price trades above the previous LH
- A new bullish trend now form making the required HH and HL
- We then notice a potential LH form (as it fails to trade above the *highest* HH and retraces towards the prior swing low. This is our warning of a bearish reversal.
- If the prior swing low remains unchallenged and price reverses to continue higher (above the *highest* HH) then the bullish trend remains intact.

TRENDS WITHIN TRENDS

This is where it gets tricky! Now you have seen the elements of a trend, we must touch on the fact that trends are fractal, which has to be the most confusing element to trends. This is the part that causes newer traders to doubt themselves as the markets retrace against them which then results in them erratically jumping in and out of trades, switching their direction along the way.

Primary, Secondary and Minor Trends

For further study you would be advised to read up on The Dow Theory. However in essence you have to imagine trends form within trends.

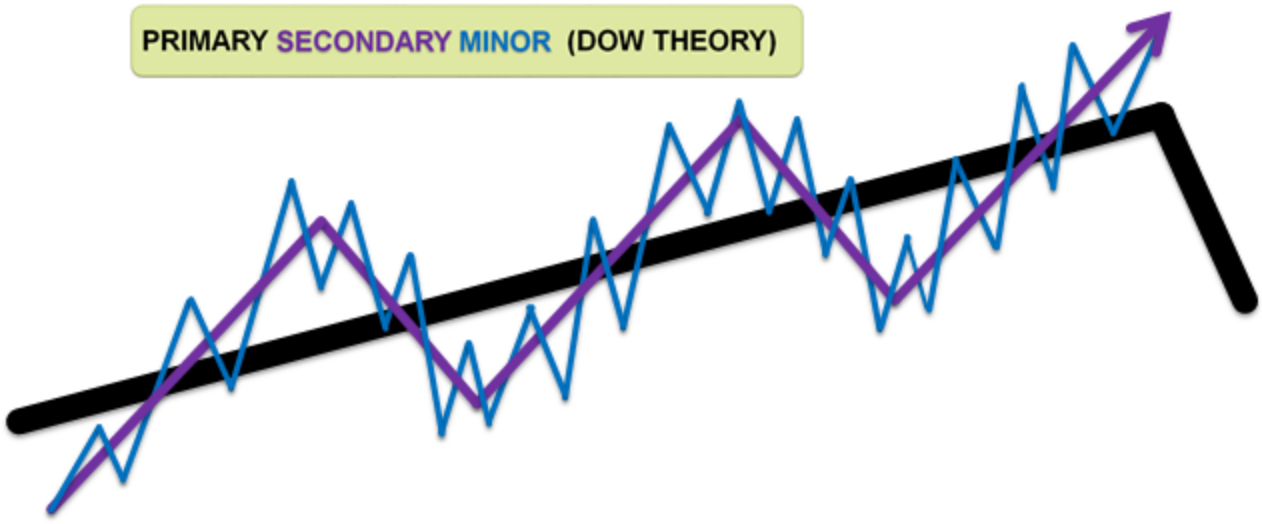
The Dow Theory separates trends into Primary, Secondary and Minor trends, which are in order of 'influence' over the subsequent trend. That means the Primary trend has more influence of the direction of the secondary trend, and the secondary trend has greater influence over the direction of the minor trend.

Conversely the minor trend has less influence over the secondary trend, and even less over the primary.

It is these relationships which make trends difficult to master (and why markets never travel in a straight line).

Markets are Fractal:

- One man's trend is another man's correction
- Trends within trends (Primary/ Secondary / Minor)
- Trends can be confusing when you start to look between the various timeframes
- The markets are fractal



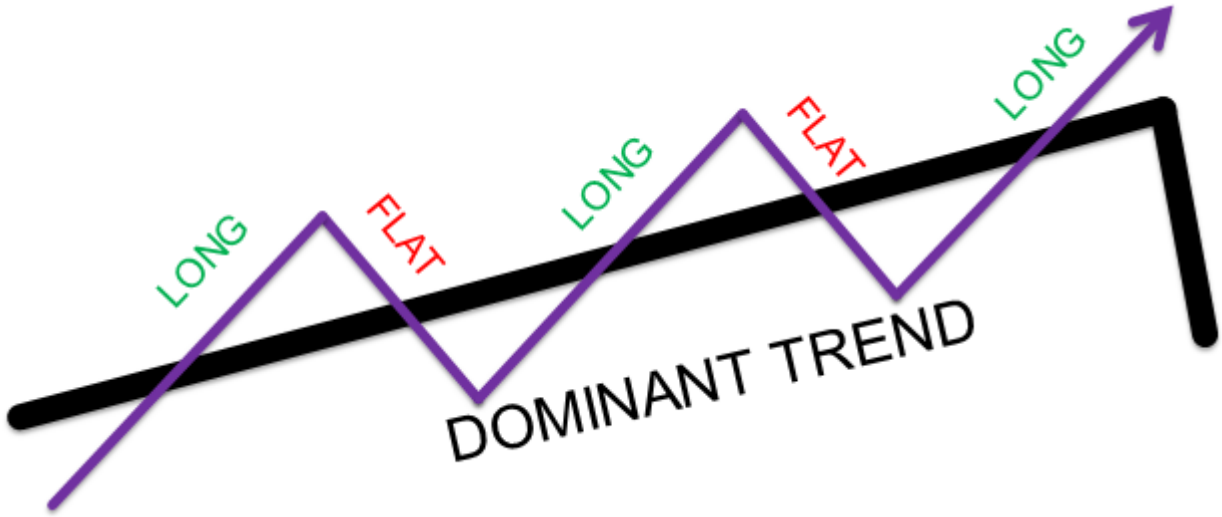
On the next page you will see the fractal nature of price on a real price chart, starting with the smaller chart and working out to the larger charts. Notice how a phase 1 bullish price move in the first chart turns out to be a phase 2 retracement on a larger chart.

HH
HL
LH
HH
HL
LH
HH
LL
LH
HL
LL
LL
HL
LH
LH
LH
LH
LL
LL
LL
LL
HH
HL
LH
HH
HL
LH
HH
LL
LH
HL
LL
LL
HL

128.348
128.457
HH
LH
HH
HH
HL
LL
HL
LH
HH
LH
LH
LH
HH
HH
LL
HL
LL
LL
LL
LL
LL
HH
HL
HL
LL

Trend Trading with multiple timeframes

- Identify a bullish trend on the daily timeframe using a combination of higher highs, moving average and trendlines.
- Identify a bullish trend on the hourly timeframe using a combination of higher highs, moving average and trendlines.
- If you have successfully identified phase 1 on the daily (so prices will begin to rise) then the highest probability trade is to identify phase 1 on the hourly. This is because it requires more effort (and money) for the market to move the prices of the daily timeframe up than the hourly timeframe.
- To take this a step further, someone wishing to take long positions on the daily timeframe may choose to only trade in the same direction of the trend on the weekly or monthly timeframe.



The best approach is to trade in the same direction as the higher timeframe.

For example if:

- Daily trend is bullish (and in phase 1) enter during *phase 1* on 1 Hour charts.
- If 1 Hour is phase 1 bearish then look to
- enter short on the
- 5 min *phase 1*

Summary

Main methods to identify a trend are:
- Higher Highs/Lows and Lower High/Lows
- Trendlines
- Moving Averages

Trends are Fractal
- So a correction to you (phase 2) is a trend to another (phase 1)
- Use Multi-Timeframe analysis to aid your trading and analysis
- A higher probability trend can be traded in line with a trend of a higher degree

Tips
- Combine the use of all 3 trend identification methods to only trade higher probability trends
- Trends are easier to identify if you zoom out from your chart, or stand back from your PC, or both
- If you spend longer than 3 seconds debating if it is a trend, then it is probably not a trend
- Remember that trends can change direction any time without so it is your job as a trader to only trade higher probability trades and accept you will jump onto the start of an impending reversal once in a while

The harsh reality about trends
- You never know in advance when they will turn (Trends, at *any* time, can change without any warning)
- You can only truly confirm a trend after the event
- The methods I have described today are there to provide you with a mechanical approach to trend identification.
- Do not beat yourself up for getting stopped out because your trend reversed – it happens to *every* trader….

REDUCE YOUR LEARNING CURVE

I hope you have enjoyed this series and found it of benefit. Whilst I would like to think you are now expert analysts just from reading this series, like anything in life, it will take time to master which will require practice and experimentation – however a great way of speeding up the process is to watch others perform analysis.

Newsroom FaceBook Twitter YouTube RSS

I would highly encourage you to subscribe to the ThinkMarkets YouTube channel and attend our weekly webinars as they include the methods used throughout the series.