Pepperstone

A THREE PILLAR STRATEGY TO SET UP YOUR FOREX TRADING

As an ambitious trader looking for success in the world of Forex, it's important to arm yourself with everything you need to feel confident in your trading journey.

Our most successful traders have solid strategic approaches underpinning everything they do. Strategy helps our clients approach their trading with an additional layer of knowledge. Their strategies normally includes the use of simple indicators as well as a risk-management tool to keep them in control.

In this paper, we've combined two of the most popular indicators from the MetaTrader 4 and MetaTrader 5 platforms into a simple strategy to get you set up to trade with confidence. We've also included a risk management tool that you can use to help you calculate appropriate trade sizes and bring structure to your trades.

The indicators we'll be taking you through include the Exponential Moving Average (EMA) and Pivot Points, supported by the Mini Terminal, an important risk management tool.

Using these indicators along with the risk management tool will help you to:

1. Identify prevailing trends in the market
2. Spot potential turning points, and
3. Select an appropriate trade size

Ultimately, this three pillar strategy will make it easier for you to understand what's happening in the market and look for potential entries with better accuracy. Let's look at these indicators in more detail.

Remember, we're here to help so if you have any questions at all, reach out to your trading specialist at any point.

1. Using EMA (Exponential Moving Average) to identify trends

What is an EMA?

Exponential Moving Average (EMA) is considered one of the most useful tools a trader can have. This tool helps traders define trends and visualise whether the price is on average rising or falling over a period of time. To activate this tool, simply drag and drop ‘moving averages’ within MT4 and make sure to update the MA method to exponential and the period as outlined below.

How to use EMAs

If the price was, on average, rising over the last 200 periods, we can consider this as a **long-term uptrend.** However, given we don't normally hold trades in the long term, we'll focus on the **10 and 21 EMA.**

When these two EMAs are moving in sync, it highlights our bias. An established trend in the market can be identified by analysing a direction of moving averages with various parameters. Generally, we use three EMAs and prefer daily charts to gain perspective, but this can be used on various time frames:

- 200 EMA: A long-term exponential moving average which covers 200 previous periods
- 21 EMA: A medium-term exponential moving average which covers 21 previous periods
- 10 EMA: A short-term exponential moving average which covers 10 previous periods

In a prevailing market trend defined by 200 EMA, a 10 EMA can be used as an indicator to highlight a correction. We confirm this correction when the 10 and 21 EMA are moving in the same direction. However, if the 10 EMA moves higher while the 20 and 200 EMA move lower, it indicates that the price is simply retraced and perhaps some of the short positions have been taken off the table while the prevailing medium and longer-term trend could still be in play.

Snapshot Summary:

Think of the 10 EMA as your finger on the pulse, the 21 EMA as a close look and the 200 as the full picture.

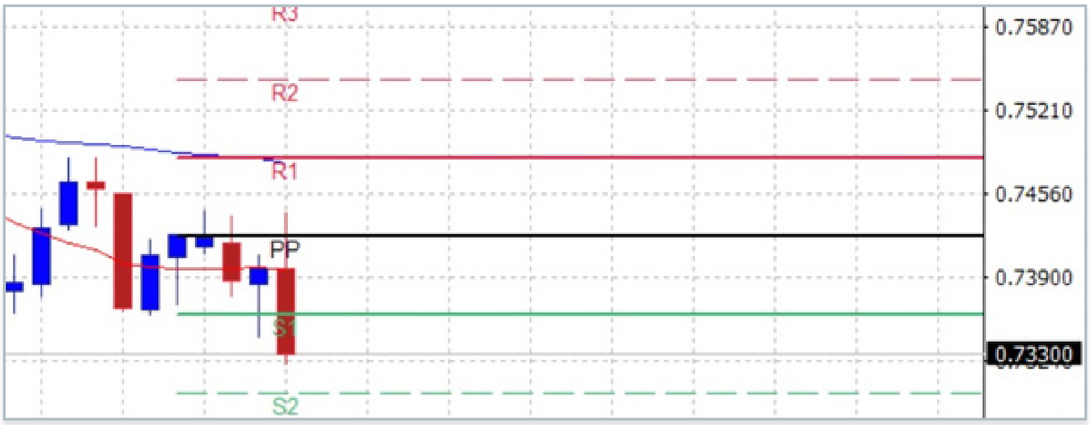
A lot of traders can get confused by this part but don't worry, it's important to focus on the longer-term market trend.

- As a buyer, you'd ideally like to see EMAs pointing upwards across different time frames, but focus on the 10 and 21 EMAs moving higher in sync
- As a seller, you'd like to see EMAs pointing downwards across multiple timeframes, but focus on the 10 and 21 EMAs moving lower in sync

Key Takeaway: The Trend is your friend

When making a decision on whether to buy or sell, it's beneficial to consider whether you are buying in the direction of a prevailing trend or not. The idea is for you to stay in line with prevailing market forces.

2. Using Pivot Points to Identify support and resistance zones



What are Pivot Points?

Pivot points are zones of **immediate support and resistance** where traders would expect the price to stop moving, pivot and reverse. Calculation of these reference points was first developed during the 70s in the famous Chicago commodity trading pits, and have been used ever since.

How to use Pivot Points

Pivot points are reactionary points. Therefore, traders would expect a support pivot point to attempt to prevent the price from declining, whereas resistance pivot points attempt to prevent the price from moving higher. You can also get a trend confirmation by seeing if the price is above or below the pivot point. However, we use this indicator to understand where to gain our entry and where to place stops and take-profits.

- **As a buyer, you'd be buying at Support.**
  This is because at the Support level, the price is expected to be at its *lowest point* before it bounces back.
- **As a seller, you'd be selling at Resistance.**
  Resistance is the point where the price is expected to *stop moving higher*.

How do Pivot Points help set stop-loss orders and take-profit orders?

Before we dive into risk management, it's important to explore using pivot points to know where to place stop-loss (SL) orders and take-profit (TP) orders. This is a critical part of any strategy as failure to understand will mean your orders may be sitting in no man's land, a point very easily reached with small price movements. As a general rule of thumb, the key is to place orders behind key pivotal levels.

- **Buyers** would be placing TP ahead of resistance levels and SL below Support levels
- **Sellers** would be placing TP ahead of Support and SL behind resistance pivot points

So while our risk management tool, which we'll discuss below, helps us identify a quantitative approach to the dollar values being risked, it doesn't consider where the take-profit or stop loss orders should be placed. This is where pivot points can also be very helpful.

Snapshot Summary:

Pivot points are used to highlight where you should place a stop-loss and take-profit order.

If you're buying, you'd look for resistance levels to put a take-profit in front of (not behind) and support to put stops below (not in front of).

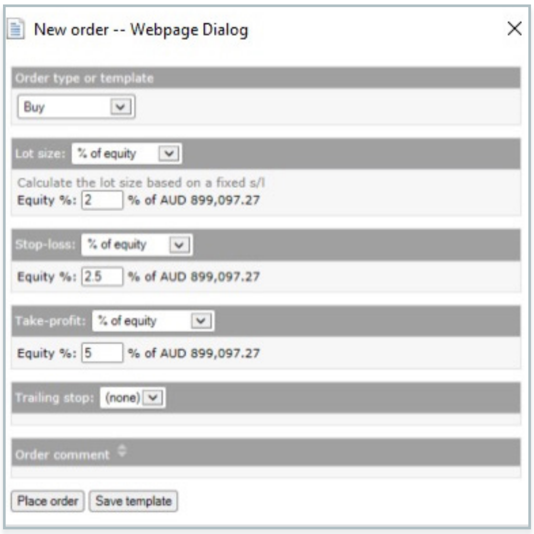
If you're selling, you'd look for support to put a take-profit ahead of (not behind) and resistance to put stops behind (not in front of).

Key Takeaway: Nothing is precise

Remember to always give trades room to breathe so you can withstand potential volatility in the market. Also, be careful not to see pivot levels as precise - they will be tested and false breaks can occur.

3. Risk Management: Balancing risk and reward with Mini Terminal

A note about risk



As George Soros, the man who famously broke the Bank of England, stated, “It doesn't matter whether you are right or wrong in the market; what matters more is how much money you make when you are right and how much you lose when you are wrong." Every successful trader might have their own approaches that contributed to their success, but they also all share one thing in common: a solid risk management practice.

The aim of a solid risk management practice is to ‘keep your powder dry' for future opportunities and, importantly, use an adequate percentage of your equity when placing a trade. Professional traders prefer to play by the rules, and when it comes to risk management it all comes down to setting up the right rules on how much you're risking per trade.

A go-to calculation when managing your positions is to risk no more than **1% to 3% of your balance or equity per trade**, but the key is to trade at a level you are comfortable with.

- Put simply, if your account is $1000, you won't be risking more than $20 per trade as this would represent 2% of your balance.
- Additionally, you wouldn't be setting a take-profit to earn less than $20, but more around the $40 mark (risking 2% to make 4% or 1-2).

Using Mini Terminal to manage risk

We offer a brilliant tool called Mini Terminal for Pepperstone clients to help them quantify the risk of a trade and clarify and manage their positions. With your pivot points highlighting where to place a stop-loss and take-profit order, our Mini Terminal manager can help you calculate the correct position size for you based on the amount of equity you wish to risk.

When using the Mini Terminal, look for the percentage of equity, not balance, as it considers any open positions your currently running.

Summary of the Three Pillars

The premise behind using these pillars is to remove any guesswork from your trading, allowing you to focus on analysing the performance of your strategy while fine-tuning your rules based on your preferences. As your risk is measured and controlled, you can get started with as much or as little as you wish.

Here's how to put everything together and formulate your strategy

1. Set your bias using EMA

Firstly, identify the overall direction of the market to develop your bias as either a buyer or a seller.

- **Buyers** would wait until 10 and 21 EMA are rising together
- **Sellers** would wait until 10 and 21 EMA are falling together

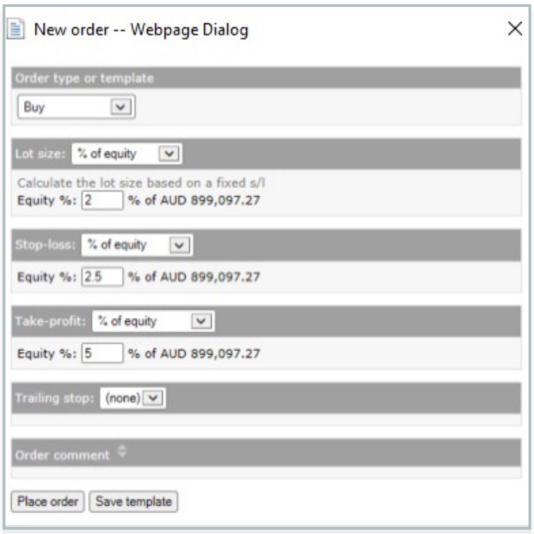
2. Use Pivot Points to identify your entry

Begin using Pivot Points to look for potential entry zones.

- **As a buyer, wait until the price is at support before you buy**
- **As a seller, wait until the price is at resistance before selling**

To place stops and take-profits
Use pivot points to identify appropriate levels for your stop-loss and take-profit levels, focusing on levels behind support/resistance for stops and ahead of support/resistance for limits.

3. Manage your trade using Mini Terminal



With these levels in mind, we can now begin to structure our trade. Use the Mini Terminal to properly measure the percentage equity you wish to risk, using the pivot points levels within the Mini Terminal as ‘Fixed Price’ for stops and limits. The Lot Size will be ‘% of equity’.

Snapshot summary of what we've learnt

For buyers:

- Rising EMAs are highlighting the underlying buy bias in the market
- Price at support pivot is highlighting a strong entry opportunity
- With Pivot Points in mind, we know where to place stops and limits
- The Mini Terminal enables us to trade a percentage of equity we are comfortable with, for example 2%.

For sellers:

- Falling EMAs are highlighting the underlying sell bias in the market
- Price at resistance pivot is highlighting a strong entry opportunity
- With Pivot points in mind, we know where to place stops and limits
- The Mini Terminal enables us to trade a percentage of equity we are comfortable with, for example, 2%.

Final Note: Putting your new knowledge into practice

You're now armed with a three-pillar strategy to set up your Forex trading and are on your way to trading with knowledge, confidence and precision. Remember, trading can be thought of as a mirror of your personality, reflecting your behaviours and attitudes to a lot of things in life. Some people like to play by rigid rules, while others like to jump out on a field and see what happens.

No matter what your personality is, we recommend adopting these simple principles and using them on your account to allow you to enjoy trading as a controlled activity where you're able to focus on trying to put odds on your side.

When you're in control, you can then make small calculated changes to continuously strive for higher accuracy, all while enjoying the thrill of the trade and the confidence that comes with knowledge and mastering new skills. To download these two indicators and your risk management tool, simply click here and download it to your MT4 platform.

EMA, Pivot Points and Mini Terminal are all part of our Smart Trader Tools package for Pepperstone clients. Speak to your Trading Specialist today to access your tools.

Happy Trading,
The Pepperstone Trading Team

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