



WALKER CAPITAL

# Insider's Guide to Forex and CFDs

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# Introduction

As the Investment Manager and HeadTrader at Walker Capital I am passionate about teaching people about forex and CFDs and guide them through the various concepts involved. Understanding how these markets work is crucial when you are trying to make a profit out of them, and there is a lot of technical knowledge involved in taking advantage of these particular markets. Thus, this book can be of great advantage in guiding you through forex and CFDs.

For someone looking to make it big in the financial field, forex and CFDs could be the best options for you, and it is one of the reasons why many people have started to understand the mechanism behind each one. If you don't know these basic mechanisms, do not worry as we will explore them together in this book and discover the ways in which you can use these markets to your complete advantage. The unpredictability of such markets can be a pain, but not so much if you manage to understand them and the concepts that control them.

However, before I start discussing how you can take advantage of these markets and make the most value of this guide, it is important to obtain a comprehensive understanding of forex and CFDs. Otherwise, the contents of this book would go to waste. You also need to understand the mechanisms and concepts of these markets as they are extremely technical. If you're worried that this guide may be too difficult for you to grasp, do not fret as I have explained the contents in a simple and clear manner so as to show my reader that forex and CFDs are approachable and modern markets.



Michael Walker

**Investment Manager and Trader**

# What is Forex?

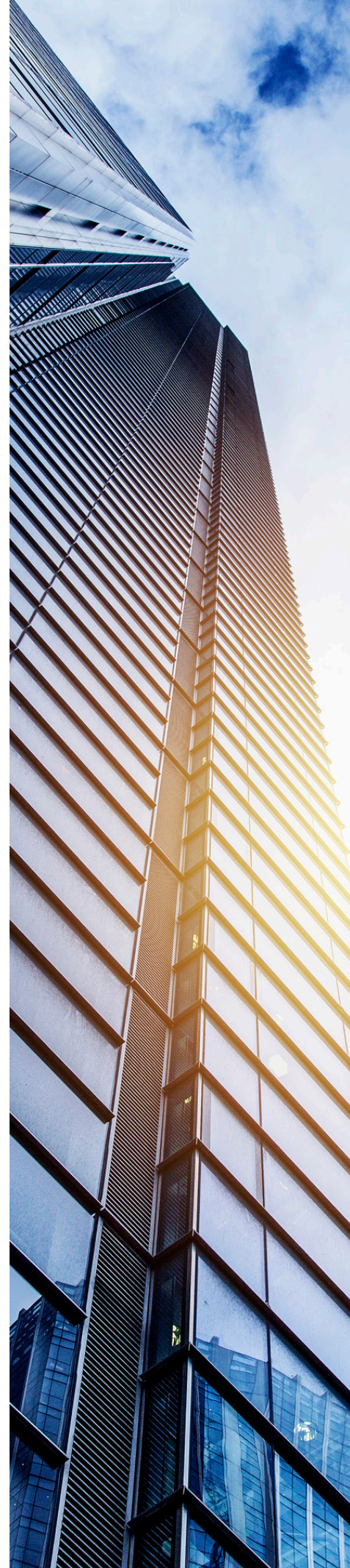
The foreign exchange market (or Forex, FX and currency market for short) is a global market for the trading of currencies.

Forex is a decentralized market, which means that there is no central authority. Forex involves the buying, selling and trading of currencies at determined prices and it is by far the largest market in the world<sup>1</sup> (obviously, it deals with the entire world's money). The larger international banks are the main ones to participate in forex.

Forex does not have the power to determine the relative values of different currencies, but the market plays the deciding role in the current market price of the value of a particular currency against another. Forex operates on several different levels, so let me break it down for you:

- » Forex works through financial institutions;
- » Banks turn to numerous smaller financial firms that are called “dealers”;
- » These “dealers” are involved in a considerable amount of foreign exchange trading;
- » The dealers make up what is called an interbank market (which also includes some insurance companies and financial firms);
- » Due to the nature of the exchange that takes place between two currencies (which involves hundreds of millions of dollars), there is little to no supervision of forex trades ;
- » The actual transactions themselves are conducted by several different market participants in several various locations.

<sup>1</sup> <https://www.investopedia.com/terms/forex/f/foreign-exchange-markets.asp>





## Forex: The Right Choice

In a typical transaction, one party buys a certain amount of one currency using a certain amount of another currency. This may seem simple, right? It is not. This is because forex connects a global system and deals with something that is so valuable in today's world that it is something that cannot be compromised. Managing the system itself is such a difficult task.

However, there are a few unique characteristics that set that foreign exchange market apart from any other market on this entire planet and they include:

- » It has an enormous volume of trading which shows how high its liquidity<sup>2</sup> (the ability to buy or sell an asset without changing the asset's price in any way) is;
- » The geographical distribution that forex handles and its international exposure; Most forex accounts trade without any commission, exchange fees or even data licenses, and this makes for low trading costs;
- » Forex is not a "bear market" as you can make or lose money at any moment;
- » The fact that forex remains open 24 hours a day, five days a week;
- » The infinite number of factors that are always affecting the exchange rates;
- » The small relative profit (especially when you compare the price with other markets that have a fixed profit);
- » Leveraging (on account size) that highlights profit and loss margins.

<sup>2</sup> <https://www.investopedia.com/terms/f/foreign-exchange-markets.asp>

A nice way to show you how the forex system works is through the following example:

**Imagine a period where the US dollar is expected to decrease in its value as compared to the Euro. In such a situation, a forex trader would be selling US dollars and buying Euros because if the Euro's value strengthens, then the purchasing power to buy dollars would increase. Thus, the trader can buy back the dollars and make a profit.**

## What are Exchange Rates and why do They Change?

So, this is all a trading game based on the predicted exchange rates. It is very rare that any two currencies have identical values at the same time in the market, and it is also uncommon for two different currencies to maintain the same relative value for an extended period.

<sup>3</sup>This is the principle upon which the concept of the exchange rate is based. Exchange rates generally are continuously changing, and they are almost always in movement (whether that movement is upwards or downwards).

Just like stocks, bonds, etc., currency is also traded in an open market. This shows that exchange rates have a tendency to fluctuate because of the constant changes in supply and demand that take place within the market. An increase in supply and a decrease in demand for a particular currency can cause its value to drop; while a decrease in supply and an increase in demand can be the reason for its value to flourish within the market.

This just goes to show that a forex trader needs to think on his or her feet and act quickly upon accurate predictions; otherwise, things may or may not fall apart for him or her.

<sup>3</sup> <https://www.investopedia.com/articles/forex/080613/effects-currency-fluctuations-economy.asp>



## What is a CFD?

A CFD or Contract for Difference is an agreement between two parties to exchange the difference between the opening price and the closing price of a contract. CFDs allow you to trade on live market price movements without actually having to own the instrument upon which your contract is based. Confusing, right? Well, let me clarify with an example:

A man predicts that the value of a specified asset will increase shortly, so he takes a position on that asset's CFDs. The aim is to take a position to make money from the movement in the asset price. The man does not buy the asset, rather, he enters into a contract where he takes a position on the price movement of the asset.

CFDs are usually used to speculate upon the future movement of market prices regardless of whether or not the underlying markets are experiencing a plunge or flourishing in any way. Also, it is important to keep in mind that CFDs are leveraged products which allow you to trade them by only paying a small portion of the value of the contract, and this allows you to magnify your return on the investment. However, you should know that the higher leverage can create losses that might exceed your initial deposit.

# The Features of CFD Trading

We have looked at what CFD trading is, and we have seen a bit of how the concept works. The features of this trading mechanism play a vital role in allowing you to understand how the entire concept works and these features are:

1. The ability to go short or long- which is the buying or selling of assets if you believe that the market value of a particular asset is rising or falling respectively. So, if you predict that the value of a particular asset is going to decrease, you will go short and use CFDs to increase your profits. With CFD's you can benefit from any movement in the market (whether that movement is rising or falling).
2. Short selling to hedge one's portfolio- this means that you can offset any loss in the value of your portfolio by using CFDs to short sell . This feature is particularly useful in volatile markets as it insinuates that one can short sell the equivalent of their shares through a CFD trade and if the prices of their shares decreases, then the loss of value of your share portfolio would be offset by a gain in the short sell<sup>4</sup> CFD trade.
3. Taxes for day trading income are paid after expenses, which includes any losses at your personal tax rate. The main rule to be aware of is that any gain you make from trading is considered as normal taxable income. However, any losses can be claimed as tax deductions<sup>5</sup>.
4. 24-hour services- CFD trading accounts are accessible 24 hours a day, seven days a. You can even trade CFDs when the underlying markets are closed.
5. Leveraged trading- to open your position, all you need to do is pay a fraction of the total trade value. This is called a margin, and it means that you can start paying once you have cleared the margin<sup>6</sup>. Leverage can be used to magnify your return on your investment as the full exposure you have had with the trade is much more than the initial deposit you made. However, your losses are also enhanced in a situation where the market managed to move against you and could result in your losing significantly more than your deposit.

<sup>4</sup> <https://www.investopedia.com/terms/s/shortsale.asp>

<sup>5</sup> <https://www.daytrading.com/taxes/australia>

<sup>6</sup> <https://www.investopedia.com/ask/answers/06/forexmargin.asp>

# The Disadvantages of CFDs

Although the features of CFDs have managed to paint a rosy picture of this particular trading market, reality is a bitter punch to the gut as there are various disadvantages of making use of CFDs, which include the following:

- » You cannot profit from small movements because you have to pay for the spreads from the Broker<sup>7</sup>
- » These spreads also lessen your winning trades by a smaller amount and increases your losses by small amounts;
- » The CFD trading market is not regulated (as with forex) in the same way as a stock exchange is, and you have to judge a broker's credibility based on their experience, reputation and financial position.

## The Risks Involved

I mentioned the disadvantages that one might face when making use of CFD trading. However, you should understand that there are major risks involved in this trading market, and they include:

- » The market risk- this is particularly enhanced by the leveraging effect of CFD trading. Margin rates are small ones, and this means that a small amount of money can be used to hold a large position, and you are gambling with predictions of market values. You risk losing substantially more money than what you have paid. The only way to lessen the effect of this risk is to use a stop loss order (which is a way to trigger an exit point that has been pre-determined by the trader).
- » The liquidation risk- to maintain the margin level when prices start to move against an open CFD position, some additional variation margin (cash funds) need to be provided. In markets that move fast, this risk and its remedy may come at short notice, and if the margins are not fulfilled on time, then the CFD provider may close the positions at a loss which makes the you liable.
- » The counterparty risk- if the counterparty to a contract does not meet their financial requirements (e.g. the party who you enter the CFD with), then the CFD may have little or no value left, and this means that the CFD trader could face severe losses even if the underlying instrument shows the desired movement.

<sup>7</sup> <https://www.cmcmarkets.com/en-au/learn-cfd-trading/what-is-a-spread>

# The Similarities and Differences between Forex and CFDs

To help clarify these concepts some more, you should know the similarities and differences between both markets as they seem quite similar on paper, but some crucial things set them apart.

## The Similarities

- » The trading execution processes in these markets are very similar to each other..
- » With Both markets you can trade on leverage.
- » They both are over-the-counter markets which have no physical location and are run electronically by banks or other market participants.
- » The spread is the only thing that needs to be paid for when initially transacting in both markets.
- » The underlying instrument is not owned by the trader in either market.

## The Differences

- » CFD trading covers a diverse variety of markets, and it involves many different contracts, while forex is purely a currency trading market.
- » When trading CFDs, one is given the chance to select from many different contracts that would vary in their value and type of currency, while forex trades one currency for another and involves uniform lot sizes.
- » CFD trading is influenced by specific factors (like supply and demand of an individual asset), while forex is influenced by global factors (like large scale employment shifts or an event occurring in a particular country).

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# Getting started

Now that you have had a crash course in both of these markets and the features involved in them, it is time to get started with the actual process of trading in these markets. You need to understand how to approach both markets and the steps that would be involved in how you can take advantage of these markets for a profit.

## Forex: How it Works

Forex trading requires you to understand the terminology that would be used in the entire process and here is a list of the terminology that would help you along the way:

- » Base currency is that which you are spending, while quote currency is that which you are purchasing.
- » The exchange rate is the amount you need to spend in base currency to buy quote currency.
- » A long position is when you want to buy the base currency and sell the quote currency.
- » A short position is when you want to purchase the quote currency and sell the base currency.
- » The bid price is that at which your broker is willing to buy the base currency in exchange for the quote currency.
- » The ask/offer price is that at which your broker will sell the base currency in exchange for the quote currency.
- » A spread is a discrepancy between the bid prices and asks price.

Now that you understand the terminology, the next step is to read a forex quote. This is relatively easy as the price you see on the left is the bid price and on the right, is the asking price (see the example below):

Market Watch: 16:33:13				
Symbol	BidA	sk	High	Low
↑ GBPUSD	1.9899	1.9902	1.9950	1.9835
↓ EURUSD	1.5720	1.5722	1.5735	1.5627
↓ USDJPY	102.57	102.59	102.85	101.48
↑ USDCHF	1.0135	1.0138	1.0172	1.0054
↑ AUDUSD	0.9262	0.9265	0.9263	0.9177

Once you have read these quotes and grasped an idea about the market's position at this point in time, to make the decision as to which currency you would want to buy and sell. This involves the following:

- » Making predictions about the economy.
- » Looking at the country's trading position to see how much its currency would value at.
- » Taking politics into consideration.
- » Reading as many economic reports as you can as a way to guide you through your decision-making process.

The next thing you should do is learn how to calculate profits as this step would help you remain vigilant of the always moving forex market. Pip<sup>8</sup> is used to measure the change in the value of currencies, and you would use it by multiplying the number of pips that your account has changed with the exchange rate, and this will tell you how much your account has fluctuated and in which direction.

The next step would be to open an online forex brokerage account. You should find someone with a great amount of experience (preferably more than 10 years), see how many products are on offer by the broker, visit the broker's website, read reviews (but do so carefully as there are such things as Internet trolls), check the transaction costs of each trade and focus on the few essentials that make a good broker (i.e. customer support, transparency, smooth transactions and a great reputation). Fill out the appropriate and required information and then activate your account.

Once this is complete, you can begin analyzing the market and then trade currencies. There are three primary methods for analyzing the market: technical analysis (which involves reviewing charts and past data collections as a means to predict future currency values);

<sup>8</sup> <https://www.walkercapital.com.au/articles/calculating-pip-value-and-lot-size>

fundamental analysis (which is when you look at a country's economic fundamentals and use the information obtained to affect your trading decisions); and sentiment analysis (which is a more subjective technique which involves analyzing the market itself to see whether it is "bearish" or "bullish";<sup>9</sup> so this method requires more skill and experience).

Then, you need to determine your margin<sup>10</sup> and place the actual order. You can even set different kinds of orders, which include: market orders (that are executed at the current market rate); limit orders (which involves the trade being executed at a particular price); and stop orders (which gives you the choice to buy currency above the current market rate or sell it below the current rates to cut down your losses). Once you have placed your order, it is time for you to watch your profits and losses.

## CFD Trading: How it Works

CFD trading works on the principle that you can benefit when a market's value goes up or down. If you think that an asset's value will rise, then it is advised that you open a CFD over that asset with a buy position (which is known as 'going long'); while you would open a CFD over that asset with a sell position if you believe that the asset's price is going to fall (known as 'going short').

As a more useful way to guide you through the CFD trading process, here are some steps that you need to follow to make most efficient use of your CFDs:

1. Allow your profits the ability to run while cutting your losses short. Do not cling on to a losing trade there is always another trade you can take and you need to preserve your capital.
2. Go with your head and not your heart. You need to look at this in a logical manner and not from an emotional perspective. Also, do not base your decisions on a "gut feeling" while logic is telling you otherwise.
3. Limit the exposure of a single trade. You should never risk more than 2% of available income on a single trade as anything more than this would just be a foolish gamble and might have the ability to wipe out your entire trading account if things go wrong.
4. Use both fundamental and technical analysis together. As mentioned in the forex section above, these methods of analysis are ideal when combined, and a good approach is to use fundamental analysis as a means of triggering the trade and technical analysis at the time of your entry.

<sup>9</sup> <https://www.investopedia.com/study-guide/series-4/introduction/bullish-vs-bearish>

<sup>10</sup> <https://www.investopedia.com/ask/answers/06/forexmargin.asp>

5. Your timing needs to be exact. You need to wait for a trigger and a confirmatory “green light” before you enter into the trade as entering too soon can cause you many losses.
6. Never add to businesses that are losing. You need to learn the difference between trending and range bounding markets (which I will explain in a later chapter).
7. Diversify your trading portfolio by trading across industries.
8. Look at your weaknesses as well. You should not give into weaknesses like greed or fear and play to your strengths as this may be a commercial game, but it is also a psychological one. The best traders can keep their weaknesses and temptations in check.
9. Make use of stop losses in a rational manner. You can't trade without them, and you can't trade with them when they are set tightly. Thus, you need to allow the market to have some space to breathe.
10. Comprehend the risk versus reward principle. This particular trade-off insinuates that a trade should not be entered where the reward is much greater than the risk.



# Managed Discretionary Accounts (or MDAs)

Forex and CFD's are can to be traded in a managed discretionary account by companies who are licensed which trade on your behalf

## What is an MDA?

A managed discretionary account (or MDA) is a service where a portfolio of investments is provided to the client, and the client provides discretion to an investment manager that allows him or her to make trading decisions about the portfolio for the clients. So, you are giving the daily decision-making power to someone else.

MDAs are used to obtain access to professional investment expertise of the persons managing your investment portfolio. Your investment portfolio is built up according to your asset preferences, risk tolerance and personal objectives. Thus, it provides a way to gain a professional opinion on your investments and get someone to make the critical and technical decisions which may be difficult for you to understand.





## Why Use MDAs?

Managed discretionary accounts are on the rise in today's market<sup>11</sup> for various reasons, including:

- » They provide clients with an integrated investment administration, management and advice system which do not have multiple layers of costs for the customer but this depends on the provider.
- » With MDAs, the client has transparency and can see the changes in the investment portfolio.
- » They can be investment solutions for high net worth and self-managed super funds.
- » Customers retain ownership of the investments, with transparency and the ability to control their tax position based on the entity they invest with.
- » Some MDAs make use of a purely "fees-for-service" approach.

Personally managing your accounts can be extremely time-consuming and it requires a lot of knowledge, so if you want to successfully manage your accounts, you would need to be constantly vigilant and make decisions that are backed by the latest information. This can be quite difficult to administer with your day job, and investors want transparency and control are now turning towards MDAs<sup>12</sup>.

<sup>11, 12</sup> <https://www.imap.asn.au/publications/latest-news/798-imap-milliman-latest-managed-account-fum-census-as-at-30-june-2018>

## How Does an MDA Work?

A person, preferably a highly qualified investment professional, manages, trades and monitors your account on your behalf. All accounts are traded within the MDA Investment Program that has been included in the MDA Contract. You will have to provide the professional with the specific and ongoing discretionary authority that would allow them to trade with your account. You do not have to make any trading decisions once this power is provided. This power also allows the professional to trade and invest funds in your account on your behalf. You remain the owner of the account and can terminate the service as provided in the MDA contract.

However, you should know that MDAs come with their risks as well. If you do not find yourself an experienced investment professional to manage your account and go with someone who is inexperienced, you might end up with greater losses than profits. Plus, the trading market is quite temperamental, so there may be times when the professional makes a wrong decision, so it's a game of luck for you when you're choosing who to give your portfolio to. Ultimately you are handing over control of your funds to a third party to manage on your behalf, which in itself has inherent risks.



# What is Swing Trading?

Swing trading with the use of different indicators is one method to trade forex and CFDs

This is a kind of fundamental trading which is short term. A swing trade typically lasts two to six days, but less than two weeks. The goal of swing trading is basically to identify the overall trend of an asset and then catch gains within that trend using swing trading. Technical analysis is usually used to look for assets that have short-term price momentum. This means that the trader needs to act very quickly to find situations in which an asset has the potential to move in such a short period.

Swing trading always assumes a larger price range, and this is why it requires a particular position sizing to minimize downward risks. More holding time is needed to create the anticipated price movement. Swing trading can be used by individual investors who have small positions so that it won't have a great amount of impact on the price of the security. Thus, they have the luxury of entering and exiting a trade within days.

Swing trading is different from day trading as swing trading needs to be held for at least 24 hours and it can go on for several weeks, while day trading takes place within the same day and is much more short term than swing trading.



# Swing High Versus Swing Low

This refers to the peak that is reached by an indicator or an asset's price. It is formed when the high of a price is more than a given number of highs that are positioned around it. Any given asset can be on an uptrend when a series of consecutively higher swing highs are shown. Refer to the figure below for a better picture of swing highs.

Thus, swing highs can be used to identify possible areas of support and resistance of an asset. This can be used to determine the best positions for stop loss orders.

On the other hand, swing lows are troughs that are reached by an indicator or asset's price. It is created when a low is lower than any other point that is given over a period. Lower swing lows show that an asset is in a downtrend, while higher lows mean that the asset is on an uptrend. Refer to the figure on the lower right for a better picture.

Swing lows are useful when the investor holds a long position in an asset as it can determine strategic positions for stop loss orders.





## How to Achieve Success with Swing Trading

Many people think that this is the most appropriate trading technique for beginner traders, but you should understand that there is a method to approaching this kind of trading that allows you to be successful. First off, you need to pick the right assets. Large cap assets that are actively traded are your best bet for this kind of trading, and they will swing most broadly between highs and lows within the market and offer liquidity for trading.

Another tip to success is understanding how this trading would work in either extreme market situations (i.e. the bear market of raging bull market). In either extreme, momentum will carry assets for a long period in only one direction, and this is why swing trading is best positioned when the markets are going nowhere. Success is only found when the trader manages to identify what kind of market is currently being experienced correctly.

# Swing Trading Strategies

Here are a few swing trading strategies that would allow you to make use of this technique in a more effective fashion:

1. Follow the price action and make use of technical analysis. These strategies are pretty standard when dealing with swing trading.
2. Do not get caught up in the company of the CFD as this is a waste of time when dealing with different assets for swing trading. All you need to understand is that you need to look at the future of your assets and nothing else.
3. Working with the trends is a strategy you can use. This is both a traditional approach and a frequently used one.
4. Working against the trends is also a feasible option, but it requires a lot of attention. Trading the counter trend is also known as fading, and it means that a trader would take a bearish position during an uptrend's swing high and a bullish position during a downtrend's swing low.
5. Use Japanese candlesticks as many people find such charts easier to interpret than traditional bar charts. You can use the candlesticks charts to find the positions where there is buying pressure and where there is selling pressure.
6. Use a T-line trading strategy<sup>13</sup> to identify the T-line and make informed decisions influenced by it. If an asset closes above the T-line, it is highly likely that the price will keep rising; but if the asset closes below the T-line, then the price is liable to continue to fall.

<sup>13</sup> <https://hitandruncandlesticks.com/t-line-trading/>

# What are Trends?

A trend in the trading domain can go one of three ways: it can go up, down or sideways. An uptrend is defined as having higher highs and higher lows; a downtrend is defined as having lower highs and lower lows, and a trend that moves sideways has a price that is set within range.



## What are Trend lines?



Trend lines are a common form of technical analysis used in trading. Trend lines are formed by connecting the tops of support levels and the lows (or resistance levels).



Connecting the prior tops and extending the line provides traders with an idea as to where the resistance is likely to be in the future; while connecting the prior lows allows the traders to understand where the next support levels will lie. However, the past performance of a product alone, is not the only relevant factor to consider when investing as it is not a reliable indicator of future performance.

## Using Trend lines

Your purpose of using trend lines is to enter the trade at an appropriate time and trade with the trend. Your first basic strategy would be to buy in an uptrend, and this would require for you to wait until the price comes down to the trendline in a retrace. You can simply take a short position with a CFD and use the same technique when you see a downtrend, where you would let the price of the underlying make its way up and touch the trend line, after which you can trade the short CFD.

Any violation of the line would be your first warning that the trend is about to change. At times, you may find that the trends change their angle, which would require you to update the trendline to take this change into account.

## Tips for Trend line Trading

1. Connect swing lows to swing lows and swing highs to swing highs.  
We want to connect two or more swing lows (valleys) or two or more swing highs (peaks). In the process, the trend line should not be broken; otherwise, it has not been drawn correctly and can lead to negative repercussions for the trader.



In the first figure, you can see that a line has been drawn between two swing lows, but the price broke through the line that was drawn and this made the line invalid. The second image is valid because two swing lows were connected by a line that remained unbroken at any price throughout its extension.

2. The more connecting points you have, the better it will be for your line.

The thing about trend lines that makes them useful as an analytical technique is that they can continue being relevant far into the future, and they can be bounced off of several times. The more times that the trend line has been bounced off of, the more the asset is building an area of support. However, you should also know that trendlines do not last forever, and a break is inevitable.

To truly validate a line, you need to need to see a price react to a line projected from a trend line that has been drawn based off of two prior points. A third aspect can help solidify the trend line further, and this can help you exploit the market in a more accurate and effective manner.

3. Buy bullish trend lines and sell bearish ones.

An upward slanting bullish trendline shows that the price has been going up, and this means that you should be in search of buying opportunities. Buying opportunities occur when the prices drop down and come close to the trendline that has already caused some upward bounces.



A downward slanting or bearish trendline shows that the price has been going on a downward trend, and this means that you should be looking for selling opportunities. Selling opportunities present themselves when the price moves up, and it comes close to the trendline that causes downward bounces.



# Fibonacci Retracement

## What is a Fibonacci Retracement?

A Fibonacci retracement is a technical analysis tool used by traders to understand when to place and close trades or when to place stops and limits. Fibonacci retracements depend on the mathematical principles of the Golden ratio<sup>14</sup>, and they are used to find areas of resistance and support in the primary movements of assets.

To calculate Fibonacci retracement levels, traders draw six lines across the asset's price chart: one line would be at the highest point; one would be at the lowest point, one at the midpoint and three at 61.8%, 38.2% and 23.6%. According to the golden ratio rule, these points should be the ones at which significant levels of support and resistance should be detected.

## How to Use Fibonacci Retracements in Trading

Here are the steps involved in making use of Fibonacci retracements for forex and CFD trading:

1. When applying the Fibonacci tool to a downtrend, use it to the start of the move to the end (the tool is always used from the left to the right), like so:



<sup>14</sup> <https://www.phillipcfid.com/golden-ratio-trading>

2. With an upward moving trend, the tool should be applied at the bottom and end at the top. Once again, it is applied from the left to the right, as follows:



3. The Fibonacci retracement levels will automatically appear once you have used the tool. They appear in the form of percentages of the total move.
4. You can use the prices at 50%, 61.8% or 32.8% as your potential long entry levels.
5. To choose the correct level to enter based on your strategy, you need to:
- » Aggressively enter as the price reaches each level and place a stop loss at the other side of the Fibonacci level;
  - » Wait until the price finds support or resistance<sup>15</sup> at these levels and then enter.

<sup>15</sup> <https://www.investopedia.com/trading/support-and-resistance-basics>

## Fibonacci Mistakes that need to be avoided

Here are some common mistakes that even very technical traders make at times. You need to avoid these at all costs as they can mess your position and timing up:

- » Do not mix your Fibonacci reference points. Keep them consistent and you should not go from a candle's wick to a candle's body<sup>16</sup> as this can create a misanalysis.
- » Do not ignore any long-term trends. The major mistake that new traders do is that they look at significant moves which have occurred in the short term, and this can lead to a lot of misanalyses. By looking at the long term trends, one can use the Fibonacci retracements in the right direction of momentum.
- » Do not rely on Fibonacci alone as there is harm in doing this. Make use of additional analytical tools as this will increase your chances of making a good trade. You need the confirmation to allow you to move ahead.
- » Do not make use of Fibonacci retracement levels over short intervals. Applying it over short intervals is quite ineffective, and it will make it difficult for the trader to decide what levels can be traded.

<sup>16</sup> [https://en.wikipedia.org/wiki/Candlestick\\_chart](https://en.wikipedia.org/wiki/Candlestick_chart)

# What is Fundamental Analysis?

Fundamental analysis is another technique used to trade. Fundamental analysis is a technique that is used to determine the value of an asset by focusing on underlying factors that affect the company's future aspects and its actual business. With this technique, you need to analyze the economic well-being of a financial entity as opposed to its price movements alone.

Fundamental analysis is used to identify those assets which are under-valued in the market, which means that they are selling at a lower price than the asset's intrinsic value. This analysis assumes that buyers would be attracted by the low prices, and this would make them buy the asset in a sufficient enough amount to increase its price.

## The Objectives of Fundamental Analysis

The objectives of this analysis technique include the following:

- » To conduct an asset valuation and predict where its price will go;
- » To make a projection on its business performance;
- » To evaluate the management of the property and make internal financial decisions;
- » To calculate credit risk of the asset;
- » To find the intrinsic value of the property.

## The Mechanics of Fundamental Analysis

To conduct this analysis, you need to complete an in-depth and all-around study of the asset and its underlying factors. This would help you determine future prices and market developments. A combination of data is used to establish the actual current value of assets, whether they are overvalued or undervalued and the future value of the assets.

# The Role of Fundamental Analysis in Trading

The first factor that you need to take into account when making use of fundamental analysis in trading<sup>17</sup> are the profit sources that you are targeting as these can help you understand how to make someone else's money on your own. There are three kinds of profit sources that are crucial to understanding:

- » When your fellow traders (with less knowledge and experience as compared to you) become a source of profit for you. You can benefit from their losses by using better trading skills.
- » Initial public offerings and issuing additional stocks can give you the chance to cash in on the discrepancy between the price of the stocks or assets and the prices at which they will settle.
- » Established companies, mutual funds and other financial organizations can act as portfolio builders for traders. The trader's profit will then become the compensation for the risks he or she has taken.

However, fundamental analysis is not suitable for any short-term decision-making methods. Thus, you should make use of it in a strategical manner for longer periods of times.

A fundamental analyst would believe that the real value of an asset is based on its stability, earning potential and ability to grow. By exploiting the mispricing that occurs when an asset is priced at a value under or over its real value, the principal analyst seeks to profit by utilizing one of the two main schools of thought: growth investing and value investing.

## The 2 Approaches

Fundamental analysts make use of two different methods:

- » The top-down approach makes the analyst start their analysis with global economics (like GDP growth rates, inflation, interest rates, productivity, etc.) and then narrow their research to regional or industry analysis (like total sales, price levels, entry or exit from the industry, etc.).
- » The bottom-up approach is when the analyst starts with a particular business and then moves on to a more macro analysis.

<sup>17</sup> <https://www.investopedia.com/articles/trading/06/fundamentalapproach.asp>



# The Problems with Fundamental Analysis

There are some serious drawbacks to making use of fundamental analysis:

- » There are an infinite number of factors that can affect the earnings of a company, its assets and price over time and take them all into consideration when conducting this analysis can be tough.
- » The data being used to carry out the analysis may be out of date.
- » The earnings that have been reported by a company might be deceptive and dubious.
- » Giving proper weightings to the different influencing factors may be difficult.
- » The results obtained from this in-depth analysis only remain valid for a short period and forecasts may become downgraded.
- » The rules of this analysis are always changing as a way to suit the trading game.
- » The fundamental analysis assumes that the analyst is completely competent, which is not always the case.
- » A single fundamental analyst will understand that other analysts will form the same point of view of the asset, and this will cause the value of the asset to be restored. Again, this may not always be the case.
- » This analysis technique does not take random events into account, like oil spillages, etc.
- » It also assumes that there is no monopolistic power over the markets.

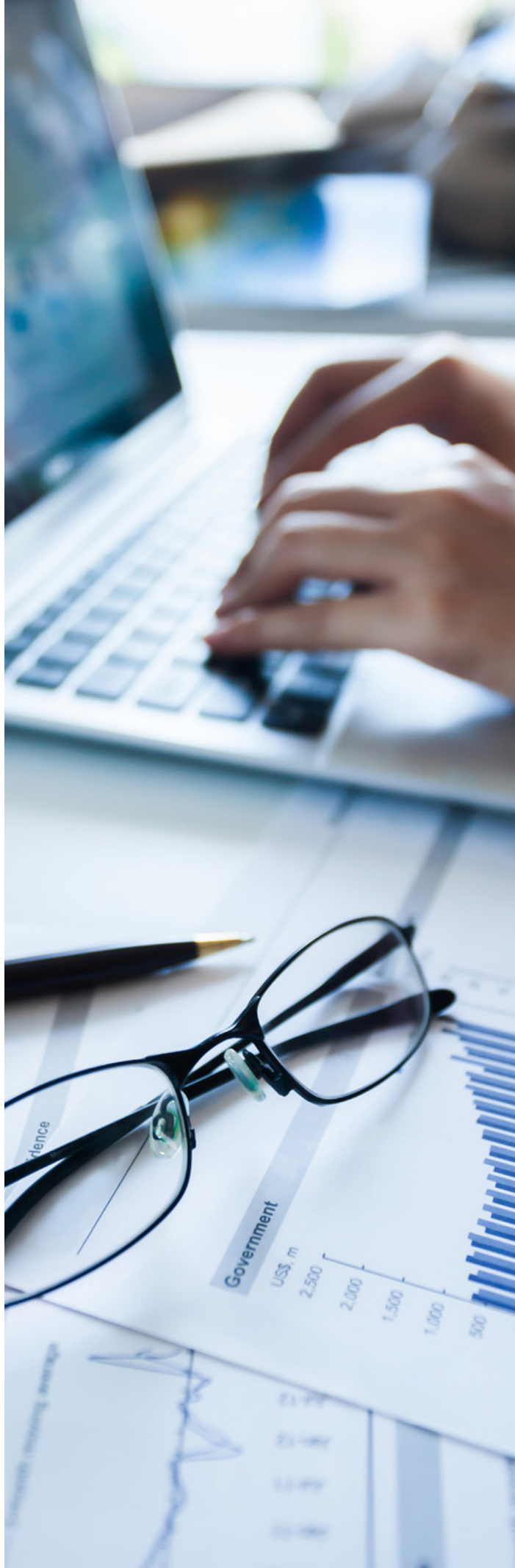
It does not indicate anything about the timing of trade, and you might have found an asset whose value has been falling for quite some time and will continue to fall, but you would not know when to make the trade.

## Criticisms of Fundamental Analysis

Followers of the efficient market theory believe that fundamental analysis is flawed because it is not possible for someone to outsmart the market and identify mispriced assets using information that is available to the public.

Another source of great criticism of fundamental analysis is the fact that many believe that it is impractical. It causes analysts to come to vague conclusions about an asset and the number of variables that should be studied.

Thus, you need to apply fundamental analysis appropriately as it does not suit all market conditions and the fact that it is quite time-consuming means that you need to make sure that fundamental analysis is the option you want to go with. You should keep all of the problems under consideration before you decide to apply fundamental analysis and it would also be best for you to make use of another technical analysis technique as a way to ensure that the decisions you make based off of the fundamental analysis are not misguided.



# What is Technical Analysis?

The technical analysis makes use of past data to predict future prices. It employs methods, tools and techniques (like the use of charts) to identify price patterns and market trends. Technical analysts also make use of different market indicators which help assess whether an asset is trending, the probability of its continuation and direction. Technical analysts (or technicians) are only interested in the price movements in the market.

Technicians identify patterns within the market that may suggest future activity as well. This analytical technique is based on three main assumptions:

- » The market discounts everything, which means that an asset's price reflects everything that has or could affect the company and thus there is no need to consider these factors separately;
- » Price moves in trends, which means that any future price movement is more likely to be in the same direction as the trend;
- » History has a tendency of repeating itself, which means that a consistent reaction is given to similar market stimuli over time.

## 10 Rules of Technical Trading

To perfect the art of trading using technical analysis, here are some crucial rules that you must keep in mind:

1. Map the trends by studying long-term charts. Start a chart analysis with weekly and even monthly charts that span over several years as a large scale map of the market provides the trader with a greater amount of visibility and a better perspective on the long-term market. Short-term market views can be deceptive.
2. Spot the trend and follow it. Market trends come in many sizes (short, intermediate and long-term), and you should determine which one you're going to trade and then trade in the direction of the trend. Also, make sure that the charts you use are by the trend.
3. Find the support and resistance levels, as the best place to buy is near support levels and the best place to sell is near the resistance levels. This rule functions on the concept that the old highs become the new lows.

4. Understand how far to backtrack. Measure the percentage retracements. A 50% retracement of a prior trend is most common, and a minimum retracement is usually one-third of the prior trend.
5. Draw trendlines. These are the most simple, yet effective charting tools that are available as all you need is a straight line and two points on a chart. Uptrend lines are drawn along two successive lows, while downtrend lines are drawn along two successive highs. When a trendline is broken, it usually shows a change in the trend.
6. Follow the averages. Moving averages are your source of objective buy and sell signals, and they help in confirming a trend change. The most popular way of finding trading signals is by combining charts of two moving averages.
7. Track oscillators. They help traders identify markets that are overbought or oversold. They also help warn traders of markets that have rallied or fallen too and may turn soon. The most popular oscillators are Relative Strength Index (RSI) and Stochastics.
8. Know the warning signs by using MACD. The Moving Average Convergence Divergence (MACD) indicator combines an average moving crossover system with the overbought or oversold elements of an oscillator. A buy signal may be justified when the faster line crosses over the slower, and both of the lines are below zero; while a sell signal may be warranted when the faster line crosses the slower line and both of the lines are above zero. An MACD histogram plots the difference between the two lines and provides even earlier warnings of any changes.
9. Use ADX to determine whether it is a trend or not a trend. The Average Directional Movement Index (ADX) line helps in determining whether a market is in a trending or trading phase. It measures the degree of trend or direction within the market. By plotting the direction of the ADX line, a trader can determine which trading style and which indicators are suitable for the current market.
10. Know the confirming signals. Volume and open interest are the most popular indicators. Volume precedes price and it is crucial to make sure that heavier volume is taking place in the direction of the prevailing trend. Rising open interest ensures that new money is supporting the current trend.

## Popular Technical Analysis Tools

These indicators and tools are used to predict future movements of prices in the market, and they are the reason for technical analysis gaining increasing popularity in the trading domain:<sup>18</sup>

- » On-Balance Volume,
- » Accumulation/Distribution Line,
- » Average Directional Index,
- » Aroon Indicator,
- » MACD,
- » Relative Strength Index,
- » Stochastic Oscillator.

## Critique of Technical Analysis

Criticisms of technical analysis include:

- » It works only because it is self-fulfilling. It only works because traders believe it works and acts by this belief.
- » There is no hard proof that technical analysis works. There seems to be evidence which indicates that the kinds of technical analysis that work change over time with different markets and time periods being suited to different methods of technical analysis.
- » Price changes are random and cannot be predicted. This belief, held by the efficient market hypothesis, states that markets react immediately to information affecting an asset's intrinsic value.

Thus, the technical analysis also has its drawbacks, but this does not stop it from being one of the most popular trading analysis techniques and the scientific approach that is used in this analysis with the use of tools, makes it quite efficient and effective in the prediction of future price movements.<sup>19</sup>

<sup>18</sup> <https://www.investopedia.com/articles/active-trading/041814/four-most-commonlyused-indicators-trend-trading.asp>

<sup>19</sup> [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2354962](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2354962)

# What is Algorithmic Trading?

Another trading method to trade CFDs or Forex is Algorithmic trading. All trading method have its inherent risks and some platforms may not allow the use of algorithmic trading.

Algorithmic trading is a method of executing a large order (too large to execute all at once) using automated pre-programmed trading instructions accounting for a variety of variables such as time, price, and volume to send smaller slices (child orders) out to the market over time. Algorithmic trading is a way to make a profit by minimizing the cost, market impact and risk in an execution of order.

## The Benefits of Algorithmic Trading

Algorithmic trading potentially provides the following benefits following the rules of the trading strategy without human Psychology decision or indecision getting in the way:

- » Trades executed at the best possible prices as per the trading strategy,
- » Instant and accurate trade order placement (thereby high chances of execution at desired levels),
- » Trades timed correctly as per the defined rules and instantly, to avoid significant price changes,
- » Reduced transaction costs,
- » Simultaneous automated checks on multiple market conditions,
- » Reduced risk of manual errors in placing the trades,
- » Back test the algorithm, based on available historical and real-time data,
- » Reduced possibility of mistakes by human traders based on emotional and psychological factors.

# Algorithmic Strategies

The following are common trading strategies used in algorithmic trading:

- » Trend Following Strategies, which is very common and follows trends in moving averages, channel breakouts, price level movements and other technical indicators. These are the easiest and simplest strategies to implement because they do not involve making any predictions or price forecasts. Trades are initiated based on the occurrence of popular trends, which are easy and straightforward to implement through algorithms without getting into the complexity of predictive analysis.
- » Arbitrage Opportunities, which involve buying a dual listed stock at a lower price in one market and simultaneously selling it at a higher price in another market. These opportunities offer the price differential as risk-free profit or arbitrage. The same operation can be replicated for stocks versus futures instruments, as price differentials do exist from time to time. Implementing an algorithm to identify such price differentials and placing the orders allows profitable opportunities in an efficient manner.
- » Index Fund Rebalancing, which has defined periods of rebalancing to bring their holdings on par with their respective benchmark indices. This creates profitable opportunities for algorithmic traders. Such trades are initiated via algorithmic trading systems for timely execution and best prices.
- » Mathematical Model Based Strategies, where a lot of proven mathematical models, like the delta-neutral trading strategy, allow trading on a combination of options and its underlying security. Trades are placed to offset positive and negative deltas so that the portfolio delta is maintained at zero.
- » Trading Range (Mean Reversion); this is based on the idea that the high and low prices of an asset are a temporary phenomenon which reverts to their mean value periodically. Identifying and defining a price range and implementing an algorithm based on that which allows trades to be placed automatically when the amount of an asset breaks in and out of its defined range.
- » Volume-Weighted Average Price (VWAP) strategy breaks up a large order and releases dynamically determined smaller chunks of the order to the market using stock particular historical volume profiles. The aim is to execute the order close to the Volume Weighted Average Price (VWAP), thereby benefiting on average price.

- » Time Weighted Average Price (TWAP) strategy breaks up a large order and releases dynamically determined smaller chunks of the order to the market using evenly divided time slots between a start and end time. The aim is to execute the order close to the average price between the start and end times, thereby minimising market impact.
- » Percentage of Volume (POV) requires the trade order to be fully filled. This algorithm continues sending partial orders, according to the defined participation ratio and according to the volume traded in the markets. The related “steps strategy” sends orders at a user-defined percentage of market volumes and increases or decreases this participation rate when the stock price reaches user-defined levels.
- » Implementation Shortfall strategy aims at minimizing the execution cost of an order by trading off the real-time market, thereby saving on the expense of the order and benefiting from the opportunity cost of delayed execution. The strategy will increase the targeted participation rate when the stock price moves favourably and decreases it when the stock price moves adversely.

## Technical Requirements for Algorithmic Trading

Implementing the algorithm using a computer program is the last part, clubbed with back testing. The challenge is to transform the identified strategy into an integrated computerized process that has access to a trading account for placing orders. The following are needed:

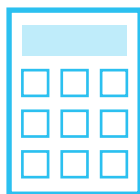
- » Computer programming knowledge to program the required trading strategy, hired programmers or pre-made trading software;
- » Network connectivity and access to trading platforms for placing the orders;
- » Access to market data feeds that will be monitored by the algorithm for opportunities to place orders;
- » The ability and infrastructure to back test the system once built, before it goes live on real markets;
- » Available historical data for back testing, depending upon the complexity of rules implemented in the algorithm.



## Conclusion

- » Thus, this book was meant to be a way for you to learn a little bit about the trading world and how to handle the ups and downs that occur in the market. However, we would recommend for you to hire an experienced and highly trained investment manager as a way for you to sit back and relax while he or she takes care of your portfolio. The entire experience would be much less hectic for you and you would have the ability to watch as you get high growth from someone who has seen the market and its temperament.
- » The cherry on top of all of this is that the forex and CFD trading domains are such technical ones, that you can't manage a day job and the trading market without going in a loss for either of the two. Thus, it is in your best interest to find yourself a trained professional and leave your forex and CFD assets to their capable and trustworthy hands.
- » The Australian Securities and Investment and Commission ASIC issued a Report in June 2018 on the profitability of Retail Traders:
  - ◆ 72% of CFD traders were unprofitable.
  - ◆ 63% of Forex traders were unprofitable<sup>20</sup>.

So either spend the time to learn the craft or engage a professional.



**Why not try Walker Capital's free Forex Trading Calculator to try your hand at Forex Trading and see the kind of returns you might expect.**

<sup>20</sup> <https://download.asic.gov.au/media/4780400/rep579-published-28-june-2018.pdf>