An Introduction To Charting

Windsor Advisory Services

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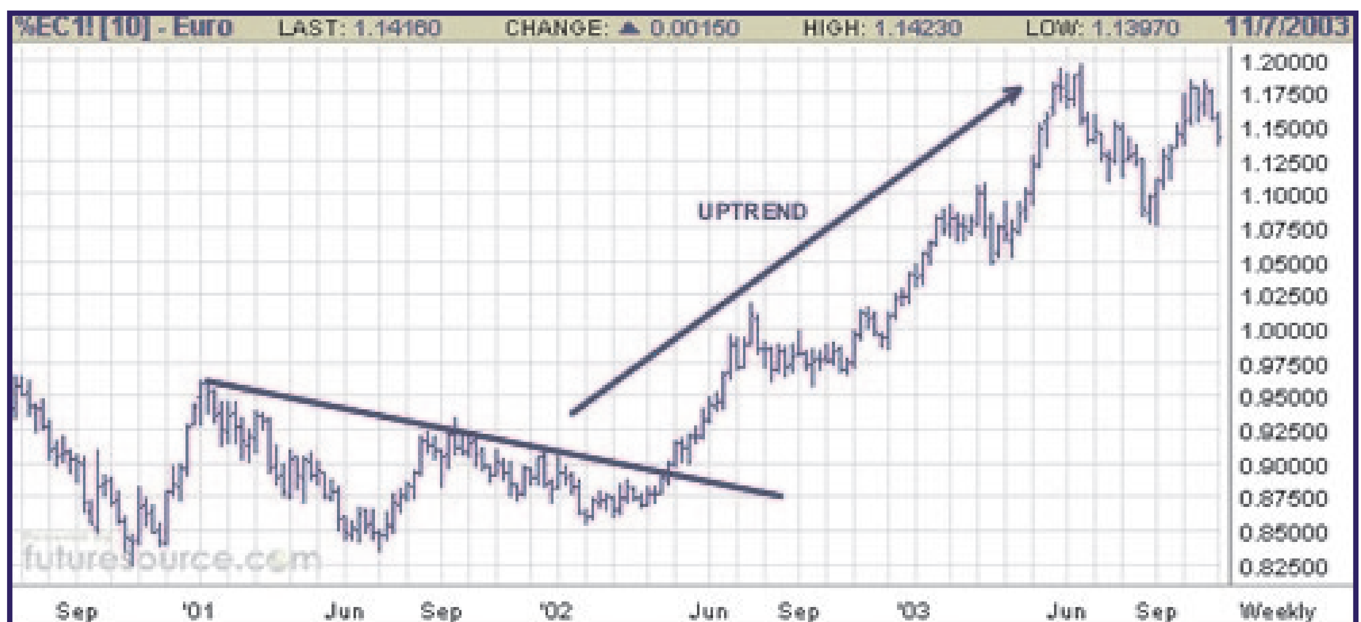
Traders to successfully trade the markets have used charts for hundreds of years and you can to, charting is a skill that can be learned and can give you a head start in your quest for consistent profits. First of all what is technical analysis? It is defined as the study of price action, through the use of charts, for the purpose of identifying price trends. The objective of the chartist is to identify the direction of the long-term trend. This will give you an introduction to the power of technical analysis and in the other report in this section we have given you a complete technical method that many of the top traders in the world use to make long-term capital gains, and maybe with some practice you could to.

One important to keep in mind is that charting is an art not a science. Many vendors promote systems that are supposed to be an able to predict market tops and bottoms in advance. There are many systems that claim to have found the natural order of the markets.

Keep It Simple

Today with the advances in computer technology and communications traders have developed highly complicated trading methods, but the fact is the best methods tend to simple. A simple method is easier to understand easier to implement and will be more robust and less likely to break in the face of ever changing market conditions.

Three Core Concepts Of Technical Analysis



Catching and holding the longer term trend can be very profitable and above you can see a great longer term trend in the euro.

Markets Discount

Prices reflect the perceptions and action taken by the market participants. It is the urgency between buyers and sellers that creates price movement. Thus all fundamental factors are quickly discounted in the price. In other words, by studying price charts, you're indirectly seeing the fundamentals and market psychology all at once. A simple formula simplifies the above discussion:

Market perception (psychology) + Fundamentals = Price action

The important point to keep in mind here is that price action reflects the fundamentals but more importantly how they are perceived. Technicians do not question why markets move,

they just want to use the movement to their financial advantage. Some of the largest moves in history have occurred without with no known change in the fundamentals. The fundamental reasons why the market is moving up or down often arise in the middle and are usually the most bullish at the top or bearish at the bottom. The failure for bullish news to move the market higher may warn of a reversal in trend. A chartist who learns to trust his own judgement rather than following the news and consensus opinion has a distinct advantage in the quest for profits.

History Repeats

A Study of history reveals that human behaviour tends to repeat itself over and over again. Since price patterns reflect shifts in human psychology, one can assume that certain patterns cycles and trends will repeat in the future. Studying past price movement also reveals what is actually high or low in historical terms. A simple concept reinforces this concept.

Price + Time = Value

We all associate value with a certain price that we are accustomed to paying over time. In general, large price moves (known as spikes) are relatively short lived. And with the use of charts, you can easily spot and take advantage of them. Prices eventually come back to value. Price spikes tend to have nothing to do with the value of a commodity but the human psychology, which we discussed in the first section of this CD. This is the true value of technical analysis it allows a trader to step back from the emotions of the majority (that eventually cause them to lose) to see the markets with a calm logical perspective and trade with in a disciplined and rational manner.

The Bar Chart

Bar charts are the most popular method of graphing commodity prices. On a daily chart, each vertical line represents the price range for the period. The horizontal hash mark on the left of the bar is the open price. The right hash mark is the closing price the high and low are of course represented by the top and bottom of the bar. Intra day and daily charts are used to identify short-term price movements while weekly and monthly charts give us the longer-term picture.

The Importance Of Time Frames

The Australian dollar chart monthly shows two great trends of over a years duration illustrating the value of holding the longer term trend

The way to make money in currencies is to concentrate on the longer-term trend. The fact is that the currency of a country reflects the overall health of the economy and economic cycles tend to last for months or years rather than days or weeks. We like to establish the long-term trend from monthly and weekly charts and time our entries via the daily charts. So why are we ignoring intra day charts? The fact is the shorter the time frame the more random the moves and the more chance there is of being stopped out of the trend. Day trading offers the worst possible way of trading taking a relatively high risk for generally a small reward. Furthermore, commission and slippage tend to eat into the traders bottom line. The fact is most day traders have the odds stacked against them, and end up losers. The longer-term trend needs to be focused on any long term chart will show you the value of this strategy.

Support and Resistance

On the above chart you can see how resistance and support are important , generally the more times support or resistance is tested the more valid the level is. Also once broken resistance becomes support and vice versa.

Understanding the concepts of support and resistance are a key to your success. Support is defined as a certain price level that buying pressure (urgency) is greater than selling pressure. Resistance is a price level, at which selling pressure urgency outweighs buying pressure. Historical resistance can easily be seen can easily be seen on the longer term weekly and monthly charts.

Why Old Resistance Becomes New Support

Imagine what traders think after a market breaks above key resistance and surges higher. The bears are either looking to liquidate or are looking for a place to get out. The bulls are even more confident and maybe looking to add to their positions. Non-committed traders have also seen the move and are looking to go long. Here’s what happens: Bears that are holding losses tend to liquidate as prices pull back to their break even point. Bulls tend to add to positions at the previous entry price that proved profitable.

Previous Highs & Lows

Previous highs and lows can act either as resistance or support. An earlier low tends to slow declines because many traders reason that prices had once before rallied from that level and will do so again. These traders are likely to go long or long or cover shorts as the previous low is approached. thus lending support to the market. But if prices slip below the old low, the role of this price level is reversed and it becomes resistance.

Those who went long before the breakdown in anticipation of a turnaround would view a return rally as a chance to get out close to break even. Those who had taken profits on shorts would be more likely to reinstate their shorts near the level where they had previously covered their positions. When large numbers of traders behave this way, identifiable support and resistance are created.

Price Patterns Within The Trend

Price patterns are illustrations of market psychology. Each pattern characterises a certain mood of the market here we are going to focus on continuation patterns.

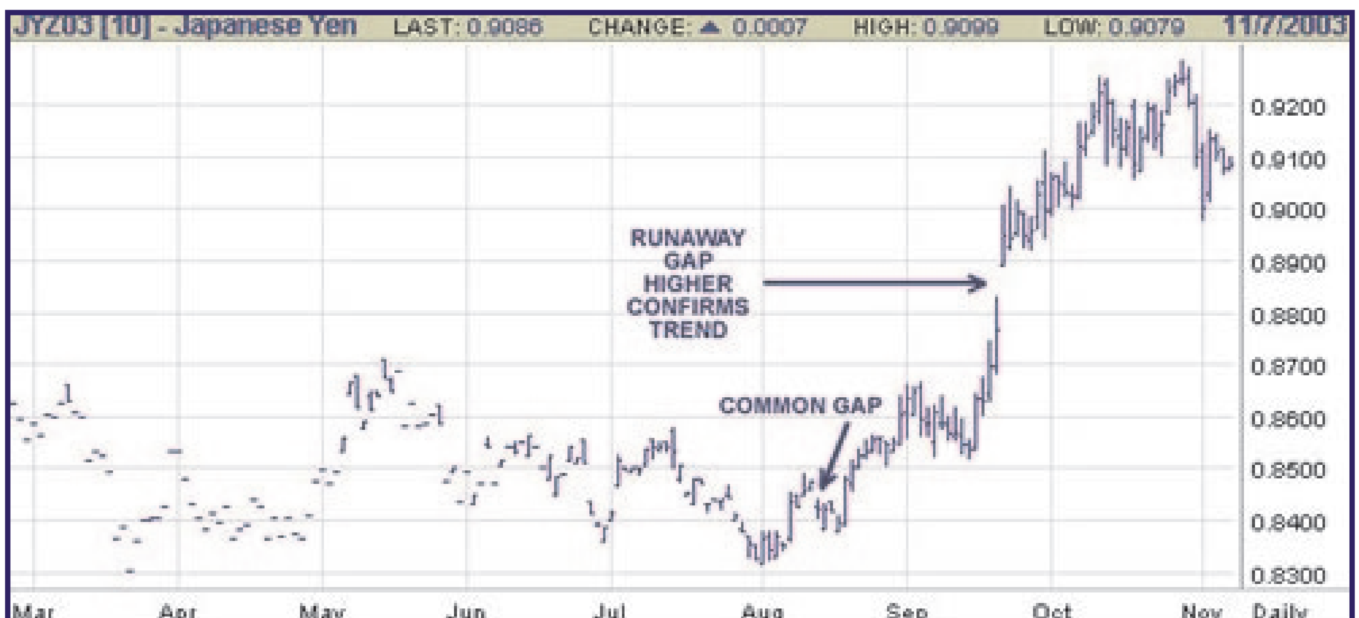
Flags And Pennants

Flags are small parallelograms that often form just after a rapid price move. They represent breathing spells in the midst of substantial rallies or declines. And give confidence to stay with the position. Pennants are similar to flags except they are triangular in shape rather than parallelograms Since these formations are easily identifiable and develop only after a clear short term or intermediate term has been established, they can be especially valuable.

Triangles

Triangles form short term up trend and down trend lines intersect. Their meaning is similar to flags and pennants, but triangles can take a lot longer to form. There are three types of triangle - ascending descending and symmetrical. The normal interpretation is that breakouts occur in the direction of the steeper trend line. Thus ascending triangles is considered bullish a descending triangle is considered bearish, and a symmetrical triangle points to a move in either direction.

Gaps



Most moves end when the emotion of the market participants pushes the trend to far in either direction and these can be accompanied by gaps.

Gaps are simply price ranges on the chart where no actual trading took place. There are four types of gap:

Common Gaps: These gaps are usually assumed to have no special meaning. Prices return to fill common gaps quickly.

Breakaway Gaps: The breakaway gap often accompanies a breakout from a congestion area or a consolidation pattern. If it is a real breakaway it signals the start of a major price trend. Breakaway gaps tend not to be filled for weeks or months.

Runaway Gaps: These occur after a trend has already been established. A specific runaway gap indicates the strength of the prevailing trend.

Exhaustion Gaps: An exhaustion gap normally occurs within the climax of a market top or bottom. The gap reflects a market move that simply runs out of steam with a final gasp. This is confirmed by the gap being filled on a closing basis.

Reversal Days

The reversal day (the same logic can also apply on longer term charts) is the simplest form of top or bottom formation. Reversal days occur when prices make a new high or low for a given period and finish below or above the prior close. If the pattern forms new contract highs or lows, they are very important and are seen as key reversal days.

Focus On The Longer Term Trend

Most traders say they are long-term trend followers but by this they mean a few weeks however the longer-term trends in currencies last for months or years. The aim of this material is to help you lock into these trends that yield the really big profits and to give you basic formations that can allow you to spot if the trend is continuing or reversing.

One important point is to look first at the monthly and weekly chart to see where the long-term trend is then time entry via the daily chart. Never look at the daily chart in isolation, as it does not tell you the full picture. The longer-term charts allow you to get a totally different perspective of trading action.

All You Need To Know For Now

The above gives you the basic of what technical analysis is all about and why it works. We have omitted many chart formations here, but what we have done here is give you an introduction to the basics, it's not definitive and you can build on this knowledge at your leisure. What it does do, is give you the background you need for the next report in this section Trading Breakouts, probably the simplest, easiest and most profitable method a trader can use to make money, read the next report and see if you agree with us!

A Note On Oscillators

Oscillators can help you time your traders with greater accuracy if used correctly. They are designed to illustrate short-term cycles in the market and prepare you for corrective moves against the primary trend. These oscillators can be extremely accurate, however during a strong trend, the overbought, oversold concept can be misleading. In a strong up trending market, only consider divergences in the overbought zone important. Also, an upturn from oversold levels or near midrange can warn the trend is resuming.

A full list of indicators is on the Windsor web site (**www.windsoradv.com**). Our favourite oscillator is the stochastic indicator, but there are, of course, others to choose from. Experiment and decide which you are comfortable with.