The Daily Fozzy Method

An e-book for trading forex daily charts

Produced by forex-rewards.com

Introduction

This e-book aims to outline a simple method of using daily charts to profit from forex. Why daily charts? Using the dailies allows the trader to work trading into his daily routine, being able to assess every opportunity but stopping the charts from taking over his life. In short, a tradable system for people living in the real world.

Most of the ideas contained within this e-book belong to the generous traders at Forex Factory's forum. You can visit that thread here at
www.forexfactory.com/showthread.php?t=7984.
My thanks go to all the traders who have shared their ideas and thoughts.

The following pages merely provide guidelines for taking and exiting trades. This book comes with no guarantees, no promises. Trades are made at your own risk and the author of this e-book is not liable for any losses you may incur. Forex is a high risk enterprise, you may lose all of your money and you should only trade with money you can afford to lose.

First steps

I use Metatrader4 for my charts. They are free and incredibly user friendly. Downloads can be found at any MT4 broker, just sign up for a demo account. A non-expiring account can be found at www.northfinance.com/eng/open-demo-account/

So we have our charts. Now we want to set up the method. First, make sure you are looking at the daily (D1). Open the navigator and expand the "Indicators" sub-root (see Fig 1). Next drag the Moving Average icon onto the RSI window and set it as an 8-period EMA (Exponential Moving Average) (see Fig 3 for settings details).

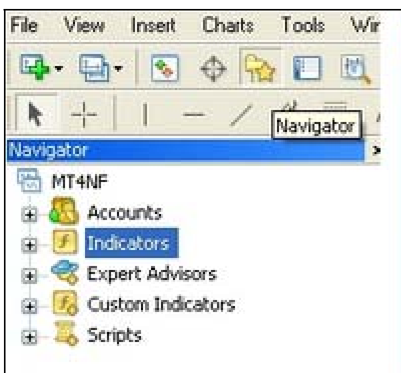


Fig 1

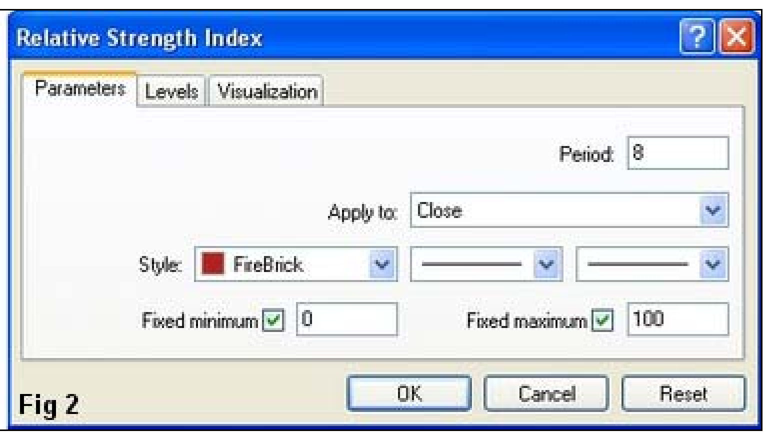
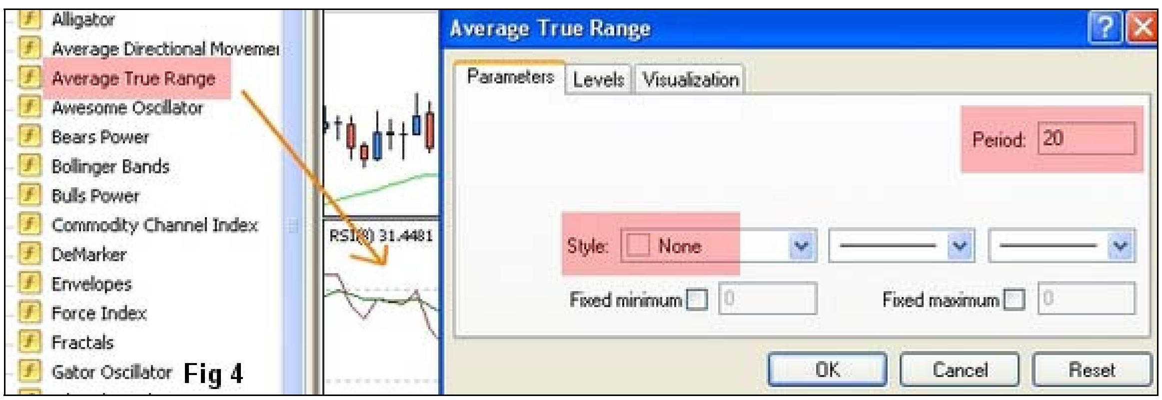


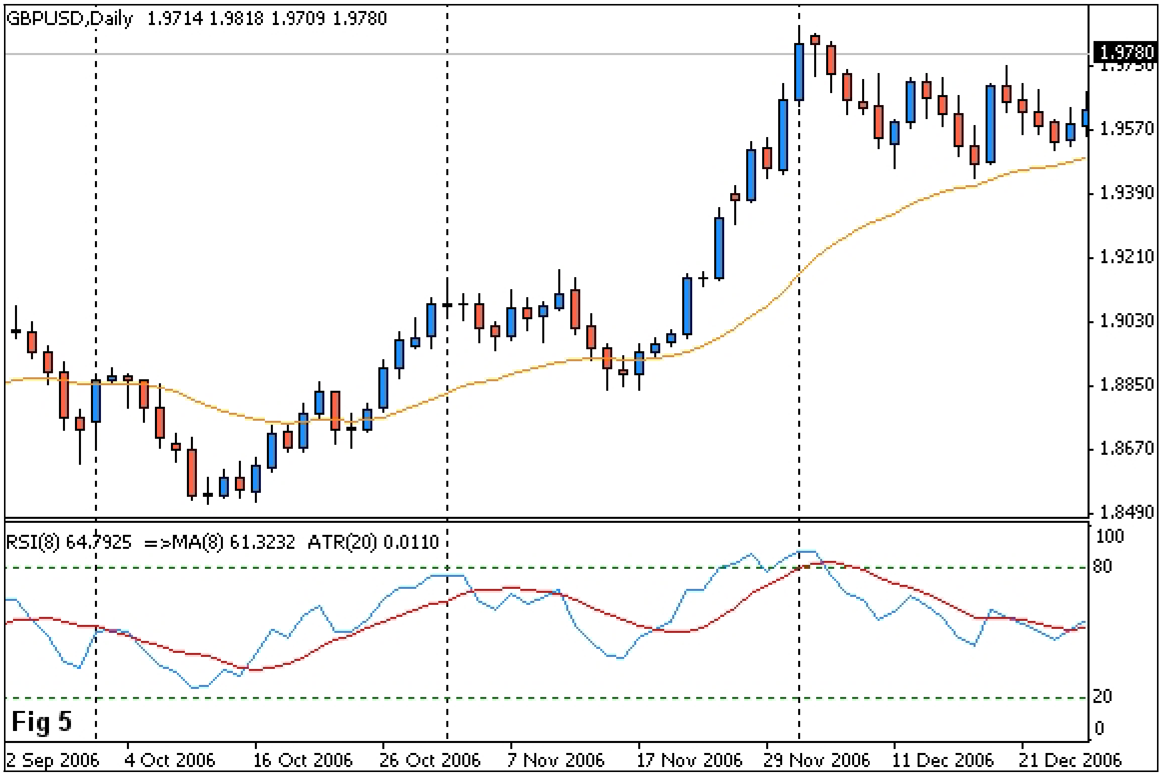
Fig 2

Next step is to put an ATR (Average True Range) figure in the window (see Fig 4). Note: We only want the ATR value, not the graph so color should be set to "none". Finally, add a 28-period EMA to the main chart window so your chart should look like Fig 5.



To avoid having to set up charts yourself, you can find a template at my home page's resource page at www.forex-rewards.com/resources. Download the file and put it in c:\program files*your metatrader4 directory*\templates.

A brief overview of the RSI indicator and related topics can be found at www.investopedia.com/terms/r/rsi.asp.



Making a trade

So let's look at making our first trade.
The rules we set for entry are very simple. We look for when the RSI crosses its moving average. Fig 6 illustrates when a trade is on. We BUY when RSI crosses the moving average from below (green box and line) and SELL when it crosses from above (blue box and line). It is vital to note that a cross is only validated after the daily candle has closed. We don't take a trade on the day when the cross has formed as it may disappear later in the day.

We enter the trade as soon as the new candle is formed i.e. at the opening price.

Daily candles (or bars) close at slightly different times depending on which broker you are using (the broker you downloaded the charts from). The link in this e-book uses North Finance's charts where the daily candle closes at 10pm GMT. Others might close at 11pm or midnight GMT. To find out when your new daily candle forms, go to the one minute chart (1M) and look at the latest candle's time. Let's say that time is 15:30. This means you have 8½ hours to wait for the next daily candle and confirmation if you have a signal to trade or not.
It's also important to note that your charts should not give a "Sunday candle" i.e. a separate candle for the first few hours of the market opening for the new week. This skews the crossover data. If you get a Sunday candle, download a new chart package from a different MT4 broker.

Since the actual method is quite simple, the main focus of this e-book deals with where to place stop losses, ways to exit a trade and selecting the best trade set ups.

Placing stops

Stop losses are vital if we are to protect our capital and live to trade another day. So where do we put them? At which point do we think "OK, I was wrong, this trade is dead, forget it and move on."?

There are a few options to look at.
One, and a powerful one which has proved very effective for me, is using a percentage of the ATR (Average True Range). The ATR shows numerically how

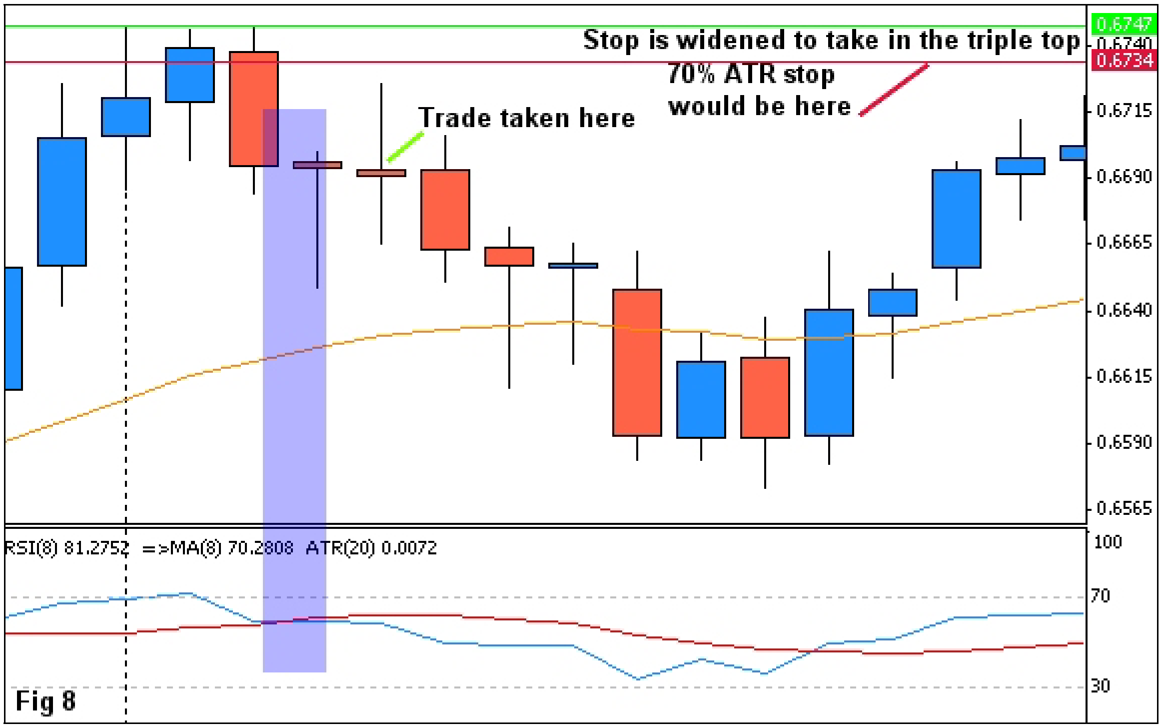
volatile a currency has been recently. A small ATR (30-50 pips) shows the daily ranges have been small, this currency pair is moving very little. A higher ATR (100-200 pips) shows a currency pair on a rollercoaster ride, either in a strong trend or ranging wildly.
Obviously for a high ATR we need a bigger stop to give the trade some room to breathe. I mostly use a stop of 70% ATR(20). Look at Fig 7 to see a stop calculation in action.

Another method for choosing a relevant stop level is simple price analysis. What levels has the price action reacted to recently? We could simply use yesterday's high/low as our stop, reasoning that if the price didn't move beyond that level yesterday, it could have a hard time doing it today. Make sure to add a buffer of 5-10 pips in case price moves to the exact level of the previous day – we don't want to get taken out for the sake of 1-2 pips.

The drawback of this method is the stops may be very large, exposing us to greater risk if we keep the same trade size, or may even be too small, making "no sense". Common sense plays a big part here. If our 70% ATR stop is only a few pips shy of yesterday's extreme, we may as well increase the stop to that level and give ourselves more chance of staying in the trade.

One strong indicator of a good stop level is a double or triple top/bottom (see Fig 8). The more price has bounced off a certain level the more important that level is. We certainly don't want to be placing our stops inside those important levels if we can help it. This is basic price analysis and more study of these patterns will, in my opinion, greatly enhance the chances for successfully trading the Fozzy method. It is outside the scope of this book but good information can easily be found online with a basic Google search of "candlestick patterns". Further basic patterns are discussed later in this e-book.

No matter how much the charts tell me though, I never place a stop bigger than 100% ATR. This is a personal rule – you must find whatever level you are comfortable with.



Exiting a trade

> “Where a calculator on the ENIAC is equipped with 18,000 vacuum tubes and weighs 30 tons, computers in the future may have only 1,000 vacuum tubes and perhaps weigh 1.5 tons.”
> *Popular Mechanics, March 1949*

When to exit a trade is, like predicting the future, deceptively difficult. It is where all the negative emotions of greed, fear and regret come out to play so having a plan of exit is vital. Here we look at a few suggestions for exiting your trades.
Traders, especially those who use daily charts, fall into two broad groups – those who like to close out trades quickly for a small profit or those who like to hang on and try to ride a trend. *You must decide what kind of trader you are, your expectations and your trading personality*. Are you happiest when closing trades for some profit quickly or are you prepared to suffer more losses, even profitable trades which turn into losers, for the prospect of riding a big trend?
Let’s first look at trying to stay in the market, in the hope that a trend will develop and carry our profits with it.

No target point, moving up stops to 70% of ATR

Here we don't set a target point (t/p or limit) where we're happy to get out the trade. What we aim to do is simply move up our stop day by day, 'locking in' profit as we go and let the market decide when the trade is over. Remember our 70% ATR stop level? Well, we place that as usual on the first day but set no t/p. On the next day, if the trade goes in our favor, we move that stop which will, depending on the movement, lock in some profit or at least decrease the stop size (and therefore risk). The aim is to get in a happy situation where we're in a trade, profit is locked in and we ride that trend with zero risk. This is known as a "Free trade".

It's best to look at a real example. On the chart in Fig 9 we are making use of a 70% ATR channel indicator to visually show where the stops are – you can of course calculate manually. The indicator is available on the resource page (www.forex-rewards.com/resources) – put it in the /experts/indicators folder of your Metatrader4 directory. Thanks to willf for posting this on the fozzy thread.

In Fig 9 we have entered a BUY trade on the GBP/JPY. Following the rules we enter at the opening price of the new candle and set our stops at 70% ATR as indicated by the lower channel (or calculated manually) – position (a). The trade goes in our favor so the next day we move up the stop to position (b). You can see this means we have locked in a small profit – we're in a free trade and all pressure is off. Next day stop is moved to (c) and we move further into profit. Then the price starts to fall a little, not enough to take out our stop, though. Crucially, the stop IS NOT MOVED LOWER. We keep it at the same level as (c) and the trade is stopped out at (d).

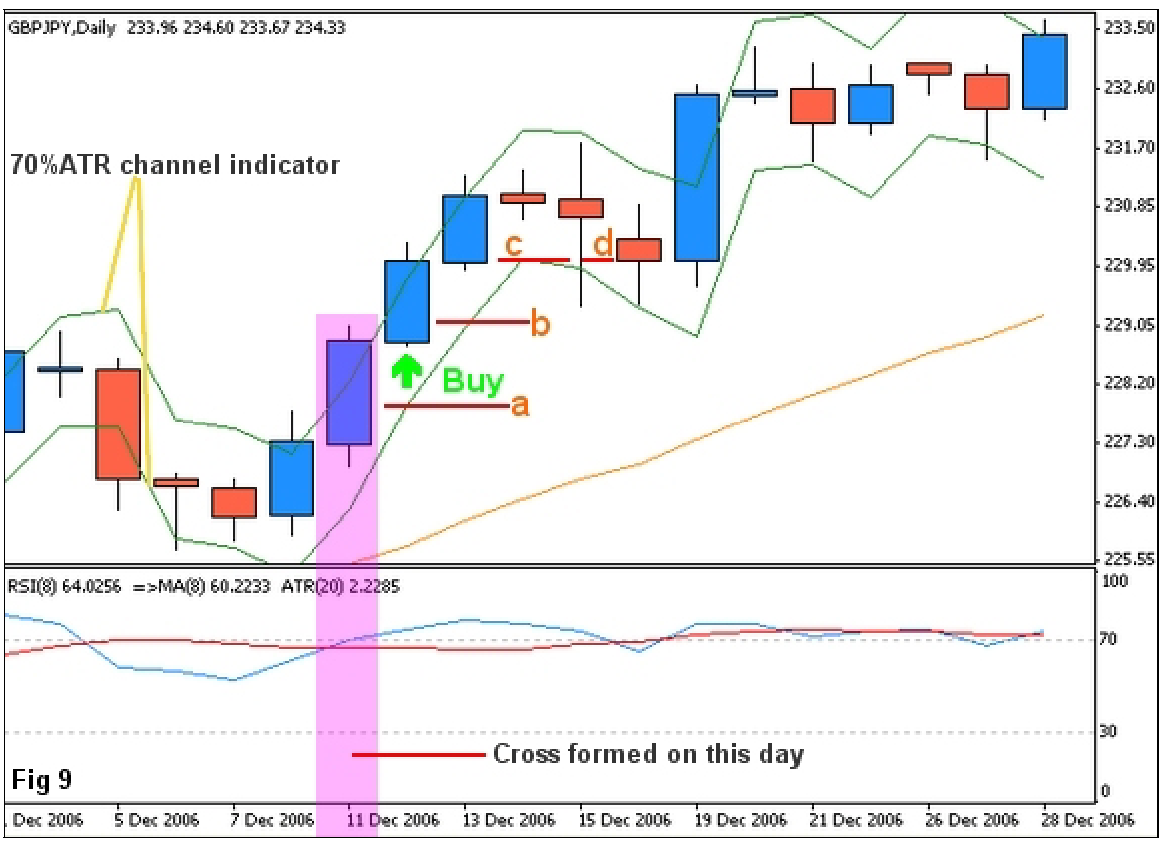


Fig 9

We’re now going to look at ways of setting a target point – a level at which you’re happy to exit a profitable trade. Remember: if you’re HAPPY exiting a trade, don’t get plagued by “if onlys” if the price continues to go on in the same, profitable direction. Make your exit plan part of your entry strategy.

Getting in and out

You may want the security of “pips in the bank” as soon as possible – aiming to get out of a trade the same day. The Fozzy method lends itself well to this strategy, (backtest yourself to reaffirm this) even setting a target which is less than your stop. This may take the form of another multiple of the ATR – equal to the stop at 70% or even lower at 50%.

Setting a limit at support/resistance areas

Areas of support and resistance (s/r) give us a logical level at which to exit a trade. If the price has reacted to a certain level in the past, we need to be aware of this when placing our target point. This could mean a recent high or low, an historical high or low, double tops/bottoms or a level which price has reacted to many times over a long period.

Fig 10

The 28 EMA as a target point

The 28 period exponential moving average is a favorite of mine when using the dailies. It often provides support or resistance and I also use it to indicate the trend (discussed later). Other traders have other preferences for moving averages – play around with different values and find your own preference.

Below are a couple of charts showing where the 28 EMA is used to exit a trade – we are predicting that price will have trouble going past this and so get out. Now of course when the EMA is far from our starting price, other methods may have to be used.

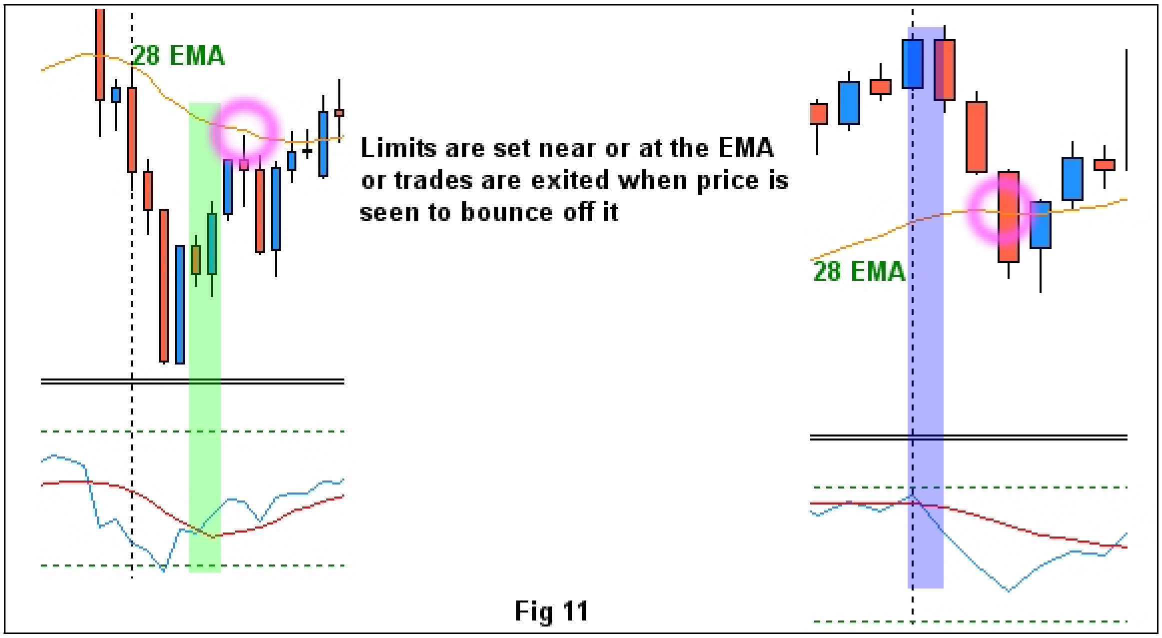


Fig 11

Using Fibonacci levels

Fibonacci levels show retracement points where price, moving counter to the trend, may bounce. Bundles of information on drawing and interpreting Fibonacci levels can be found on the web. When we are trading counter to trend, these levels give us a good point to put our targets. In my trading of the Fozzy, I look most to the 50.0 level.

Below is a chart illustrating this point and also how we can use the 28 EMA and s/r to back up our t/p decision. This 'convergence' is a crucial part of chart analysis and we look at it further in the "Choosing the trades to trade" section.

Multiple lots

There is of course a middle ground to the choice of using a target point (limit) or not and that is to use two (or even three) lots. Say I want to trade 1 standard lot - $100,000 – but instead of choosing whether to put a t/p or not, I want to have two different trades, one with and one without. This means splitting that lot in two – two $50K mini lots. On one I choose a limit using one of the methods outlined above and the other I leave open (the 70% ATR stops method), hoping a trend develops and riding it for all it's worth. I place identical stops on each trade.

………....

Above is the outline for a trading system. It is one I and others have used to considerable success. This doesn't mean it will be a success for all who try it. I recommend trading this for a least 1-2 months on a demo account, getting a feel for the method and for each currency pair (and on demo try to trade as many pairs as possible). If you're comfortable after that, look to be more selective in which trades you take. Add in something you think makes it better, make it your own.

The following chapter looks at being more selective, waiting for the best set-ups to appear.

Choosing the trades to trade

A handful of patience is worth more than a bushel of brains.
Dutch proverb

Do you trade like this…

….or like this?

You don't always have to be in a trade – in fact not taking a trade is a position too, just as going long or going short is. Here are some things I personally look for to give me confidence I'm entering a good trade. I'm not always right, nobody is. I'm merely looking to improve my odds of being right.

Going with the trend as shown by 28EMA

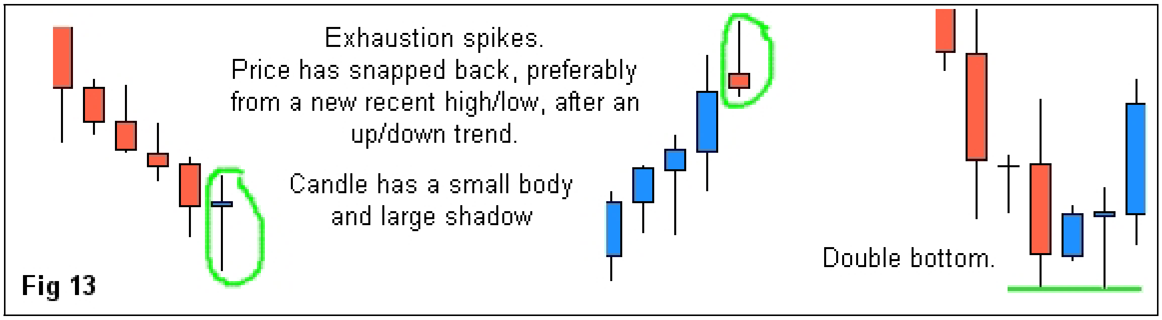
Look at the recent history, say 4 or 5 months, of a pair – is there a strong trend? Look at the 28EMA – has price stayed on one side of it? If the answer is yes, then do we really want to be guessing the end of this trend?
All I'm doing is playing the odds. In my experience going with the trend, if there is one, produces a lot less stomach acid and a few more pips.

In real terms this means ignoring the crosses which go against the bigger trend, waiting for the subsequent cross to get back into that trend, or taking the counter-trend signal while lowering my t/p expectations. Following the trend can be taken to mean not just the daily but weekly trend too. Take some time when evaluating your trades on the daily charts to click on the weeklies to see if the trends agree.

Of course there are occasions where we should be looking to trade against the trend and below we'll look at some.

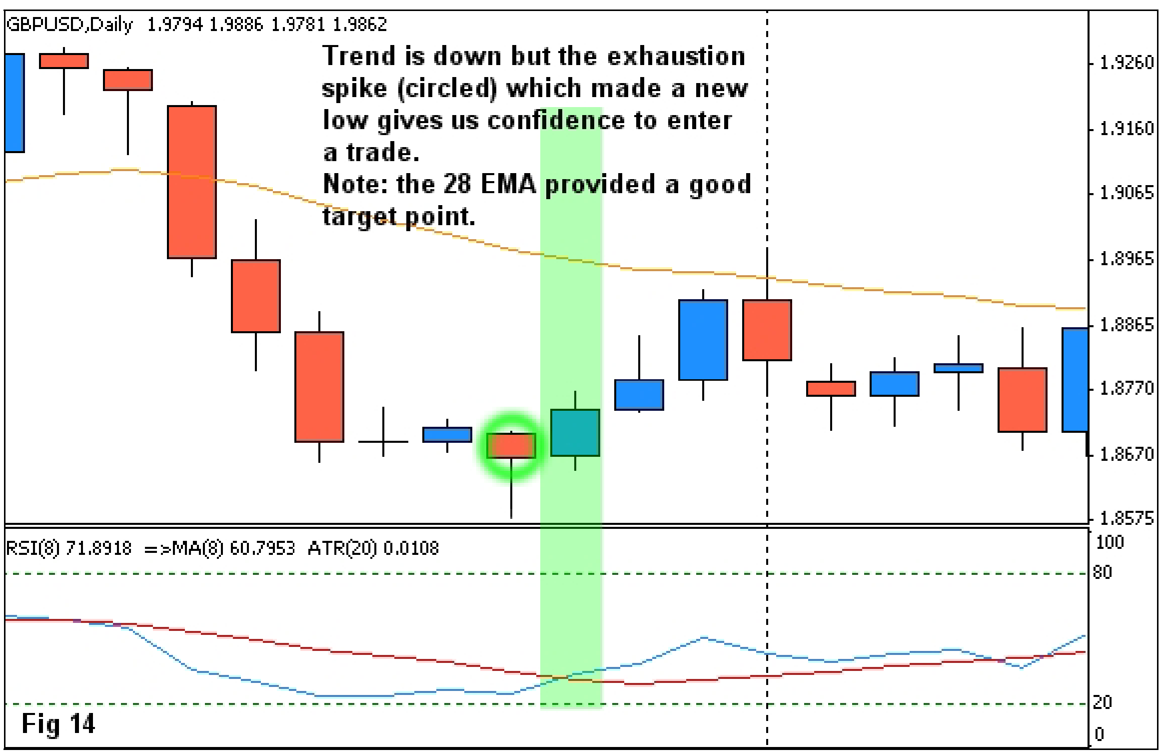
Bucking the trend with double tops/bottoms and exhaustion spikes

Candle patterns play an important role in determining a potential turning point in price. If I see one of these patterns when a cross occurs I'm usually on board. Look at Fig 13 for descriptions of these candles. *Note: the usual terminology for an 'exhaustion spike' is either a hammer or a shooting star – I just think the first term is easier to visualize.*



It’s important to note that candle patterns are not enough by themselves to give a green light, we must use other indications that a top/bottom is in place and in our case that comes as an Fozzy cross.

Here is a chart showing when candle patterns give us the confidence to enter a trade against the established trend – i.e. picking a top/bottom.



Let me repeat, using tools like these only attempts to improve our edge. These charts show when it does work out. There are plenty of times when the trades fail.

Waiting for convergence

As mentioned in the Exiting Trades section, we come back to our friend convergence - the intersection of different technical tools.

In my trading I look most often at Fibonacci levels, the 28 EMA and trendlines. When I see price bouncing from these, it's a big heads-up. If they're accompanied by a support/resistance level or candle pattern then it's game over.

The chart below shows an example of different technical analysis techniques giving back-up to the Fozzy cross and giving us the confidence to enter a trade.

Ignoring 'back-to-back' signals

If only all charts had nice big sweeps with large trends which deposited pips galore into our account. Unfortunately we have to trade in the real world where price whips back and forth and produces multiple losing cross signals.

While accepting losses is a big part of becoming a successful trader, we need to look at avoiding the down times as much as possible. When a cross comes immediately after a cross, especially if the 8EMA is flat, it may be time to put on your sniper's hat and sit it out and if you *are* taking a trade in these conditions you'll want to keep your t/p conservative.

In ranging markets there is the choice of ignoring the Fozzy crosses (when there are back-to-back-to-back signals) and instead set up a breakout play based on recent highs and lows. Look to adapt, accept your losses as part of doing business and there's more chance you'll come out the other end of a testing time.

Fig 16

Not taking a cross due to important news reactions

Without wishing to write a whole chapter on news releases and their affect on price, it is important to take into account crosses which happen due to a single news release. That is, the price reacts to some unexpected political or economic news, drops like a stone and we have a bagful of crosses the next day.

Looking at the FF calendar, www.forexfactory.com/calendar.php, would tell you what, if anything, caused the price to move violently. The most important thing is how we deal with these crosses. Personally I'm wary of taking a trade on the back of a news release and prefer to sit them out or limit my exposure. One I do make an exception for is any surprise interest rate hike which has more potential than other data to impact the market for several days and can initiate a trend.

Waiting for a retrace on bigger moves

If a signal does happen due to one large move, be it news-related or not, and I decide to take it, this is the only time I don't automatically look to get in at the opening price. In my case, I wait for a retrace in price using the 23.6 or 38.2 Fibonacci levels of the previous day's high and low. This enables me to get a better price and means I can lower my stop loss level too. Sure you're going to miss some trades when the price doesn't retrace and keeps on its merry way but, as always, we're not trying to catch every pip, just increase our odds for success.

Some final thoughts

Risk exposure and minding correlation

Risk exposure is another key to the long-term success of any trading method. In black and white terms this means what percentage of your capital are you willing to risk on one trade. Risk too much and you'll be forever playing catch-up. Consecutive losses will happen and being sensible with trade sizing will ensure we stay in the game through a rough period.
While with experience you may be able to judge risking more or less depending on your confidence in the trade, it is best to start off small.(whether you're new to trading forex or trying a new method).
Personally I am comfortable risking up to 3% of my equity on an Fozzy trade. This doesn't mean I always risk this much and certainly, if you're starting out and feeling your way, use 2% or even 1% risk. I have prepared a simple yet effective excel tool for calculating what size lots you should be trading. As always, it's on the resource page at www.forex-rewards.com/resources. Never decrease your stops so you can trade more lots – determining stops comes first, then calculating how much that stop allows you to trade.

Excellent examples and advice can be found on www.forexfactory.com/showthread.php?t=3690. Take the time to read and digest – you'll be glad you did.

Another consideration is how many currency pairs you are going to trade. As I mentioned above, when demo trading trade as many as possible for practice - and in real trading we also want to be trading a basket of pairs to ensure we get a good amount of signals. But when trading for real we have to be aware of correlation i.e. currency pairs which move in the same direction.

Take EUR/USD and USD/CHF for example. These two pairs often run in mirror-opposite directions so when you get a BUY cross on one, you'll more often than not get a SELL cross on the other on the same day. Taking both, you're effectively doubling your exposure as both will likely have the same outcome.
A safer strategy would be to look at pairs which move more independently of each other, say, EUR/USD and USD/CAD or GBP/JPY. This gives more diversification and so less chance of taking a big hit to our account.

Backtesting for confidence

Picture this. You're trading the Fozzy method, everything is going along fine and then BOOM – five losing trades in a row. How you respond to this is crucial to your success, not just in this method but in any.

You can pause, look back at your trades, read your trading log, read this book again. "Was there anything I missed? What can I learn from this?".

Losses happen – what can give you the confidence to stick with a certain method and not just give up and look for the latest new thing offering "500+ pips/month GUARANTEED!!!!"? Confidence comes from backtesting. Going over the charts one bar at a time and assuring yourself that this works. If you haven't done that pencil work you're more likely to give up when the losers roll in (and roll in they will).

I've done that pencil work but I'm not trading your account. Confidence to trade through a rough period only comes from the rock-solid belief that "Yes, this has happened before but look – it picked up again. I know because I tested it."

Good luck on your trading career. I hope this e-book will go some way in making it more successful.

This e-book was written by Michael Dunbar. Michael lives and works in Japan and has been trading forex for over four years. Some days he even thinks about other things. All material, advice and feedback is provided free. Michael is also an introducing broker for a number of firms and as well as taking time working for each trader, he also gives cash rebates on every trade his clients make with selected brokers. See his website, www.forex-rewards.com, for more information on how to claim your guaranteed rebates for very little effort and no risk.