

International Academy of Exchange Trading

Lesson 9: A Simple Trading System



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Risk Warning

High Risk Investment

Trading foreign currencies on a margin carries a high level of risk, and may not be suitable for all investors. The high degree of leverage can work against you as well as for you. Before deciding to trade you should carefully consider your investment objectives, level of experience, and appetite for risk. The possibility exists that you could sustain a loss of some or all of your initial investment and therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with foreign exchange trading, and seek advice from an independent financial advisor if you have any doubts.

Internet Trading Risks

There are risks associated with utilizing an Internet-based deal execution trading system including, but not limited to, the failure of hardware, software and Internet connections. Since Forex Club doesn't control signal power, its reception or routing via Internet, configuration of your equipment or reliability of its connection, we cannot be responsible for communication failures, distortions or delays. When trading via the Internet Forex Club employs back up systems and contingency plans to minimize the possibility of system failure, and trading via telephone is always available.

Market Risks and on-line Risks

The trading platform provides sophisticated order entry and tracking of orders. All stop-loss, limit and entry orders are guaranteed against slippage except in extraordinarily volatile market conditions. Trading on-line, no matter how convenient or efficient, does not necessarily reduce risks associated with currency trading. All quotes and trades are subject to the terms and conditions of the Client Agreement.

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Trading systems are used to systematize the trading process and help minimize the negative effect of the psychological aspect of trading.

A trading system is a set of rules identifying the criteria that must be met to open and close a position. If these rules are clear and unambiguous, they will significantly reduce trading related stress.

The trading system must be complete and fully understood by the trader before trading starts and all trades carried out once trading has started must obey the rules of the system.

Different trading systems have different sets of rules for identifying optimum entry and exit points. Complex trading systems impose a number of requirements for a signal and overly complex trading systems will only make life more difficult for the trader. What you need here is a balance between complexity and usefulness.

The novice trader can learn a lot by testing and analyzing a number of trading systems on historical data.

The first thing to think about when you are choosing (or at a later date designing your own) trading system is the time frame. Do you want an intraday trading system or a day trading system? This will depend on the time and funds at your disposal and your goals.

The trading system should also identify the instruments it is going to work with. If it has been designed exclusively for EUR/USD, it doesn't necessarily mean that it will not work with other currency pairs and this is something you could test out for yourself. It may well work with other pairs, especially after some tweaking.

The trading system should state whether it is a trend following system, a trading range system or a system that identifies common elements in ranges and trends. Trading systems may well also have rules about the size of the position. Sometimes the lot is fixed and sometimes it changes as a result of the previous day's trading.

Most trading systems use different aspects of technical analysis to generate signals. These include levels, lines, chart patterns, candle patterns and technical indicators, amongst others. Different trading systems will place different weight on different signals.

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Designing a trading system is challenging and satisfying work. If you want to learn more we recommend signing up for our distance learning course on our Academy page. The courses listed will take you through all the elements needed to use different trading systems and gives a good insight into the necessary elements of trading system design.

We'll round off our lesson today with an example of a basic trading system which we have included to illustrate the bare bones of trading system design. If you decide to use it to trade, please bear in mind that a rudimentary trading system like this is likely to generate false signals, so you must use the system at your own risk.

- Instrument: EUR/USD
- Time frame: 1 hour
- This is a trend-following trading system. The trend is identified with a SMA (24). When the SMA is below price, an uptrend is signaled and when the SMA is above price a downtrend is signaled.
- A position is opened when Stochastic (5,3,3) signals that a correction is over and that price has resumed moving in the direction of the trend. Stochastic signals this when the %D line (the dashed blue line on the chart) leaves the overbought or oversold zones. When %D leaves the overbought zone (level 70%) we sell and when %D leaves the oversold zone (level 30%) we buy.
- The position is closed by OCO and the levels of the orders are set by the entry position. The stop loss is set 40 points from the entry level and the Take profit is set at 80 points from the entry level.
- The stop-loss trails price in the direction of our position, tailing until the stop reaches the break-even point, although it will continue to trail to protect unrealized profit.

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The chart shows a trade generated by the trading system on 21.09.2006 at 01:00 GMT. Price is above the MA which signals an uptrend. Stochastic %D has left the oversold zone signaling that the correction is over and the trend is continuing. A long position is opened at 1.2709 - 0.0005 = 1.2714 (there are Bid prices on the chart but we buy at the Ask 1.2709 which is 5 points higher because of spread). We place our orders as shown on the chart. The position closed at the take profit level of 1.2794 on 21.09.2006 at 20:00 GMT. Result: 80 points, that's \$80 with a lot of \$10000 (0.01) and \$240 with a lot of \$30000 (0.03).

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You should test any and every trading system on a demo account before using it for trading. If the trading system gives you the results you want, start using it. If it doesn't, either modify it or reject it. When you test a trading system, rate the number of signals it generates in a period of time, how many of these signals were profitable and how many made a loss, and what was the average size of a profitable position and the average size of a losing position. For instance, if you have a trading system which generates 110 profitable signals and 40 unprofitable ones, it looks like a good trading system. However, if the average profitable signal made 7.3 points and the average losing position lost 35 points, then you need to reject the system.

A good trading system relieves both the beginner and the experienced trader of a lot of stress.

- A trading system provides a plan and a goal: it gives your trading a framework.
- No trading system can give you 100% success. A good trading system ensures that you lose less than you gain. This is the basis of any capital management scheme.
- Always be open to improve your trading system and to test out different systems. A better trading system means better returns.

Forex Club recommends

1. Bless My Pips. You can download this book for free from www.fxclub.com/ebook.

Homework

1. Set up our simple trading system on our platform. Compare the system against past data. Find the profitable trades that were signaled throughout the days. Find the signals and calculate the profit/loss on them.
2. Follow the system throughout a long timeframe (a year should be good). Assess it.
3. Have a go at designing a second trend-following trading system which uses 2 SMAs to signal a trend.
4. Decide:
 - a. The signal to open a long/short position
 - b. Time frame
 - c. Instrument
 - d. Size of lot
 - e. Closing: should it be based on the entry level or should you close on a signal?
 - f. Time of holding a position.

Well, that just about wraps up our Forex Primer series of lessons. We hope that you have found them informative and that they have whetted your appetite to learn more. If you have any questions, please contact us at info@fxclub.com. Visit the academy website which we are constantly updating and improving - www.ustradingacademy.com. Please feel free to visit the academy forum as a guest or sign up to make a comment or ask a question.

Forex Trading is easy and difficult at the same time. It is easy to open and close a position and to place orders etc. You don't need any specialist knowledge or advanced technology. You can trade at home, at work or in an internet cafe. The difficulty lies in opening and closing in the right direction at the right time. This is especially difficult because you need to deal with your own psychology which often works against you by stressing your decision-making ability. The trader's journey is an inner journey.

There are a lot of stories around about how people with a small start-up made big money on the markets. There are also a lot of stories about how traders lost their all in the twinkling of an eye. It's all down to the individual and their attitude to money and risk. If a trader respects money and balances risk with possible result, then success is merely a matter of time and application.

Forex Club Trading Academy is here to help you. [Contact us today.](#)