

Top Forex Trading Strategies

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WHAT IS A FOREX TRADING STRATEGY?

A forex trading strategy defines a system that a forex trader uses to determine when to buy or sell a currency pair. There are various forex strategies that traders can use including technical analysis or fundamental analysis. A good forex trading strategy allows for a trader to analyse the market and confidently execute trades with sound risk management techniques.

FOREX STRATEGIES: A TOP-LEVEL OVERVIEW

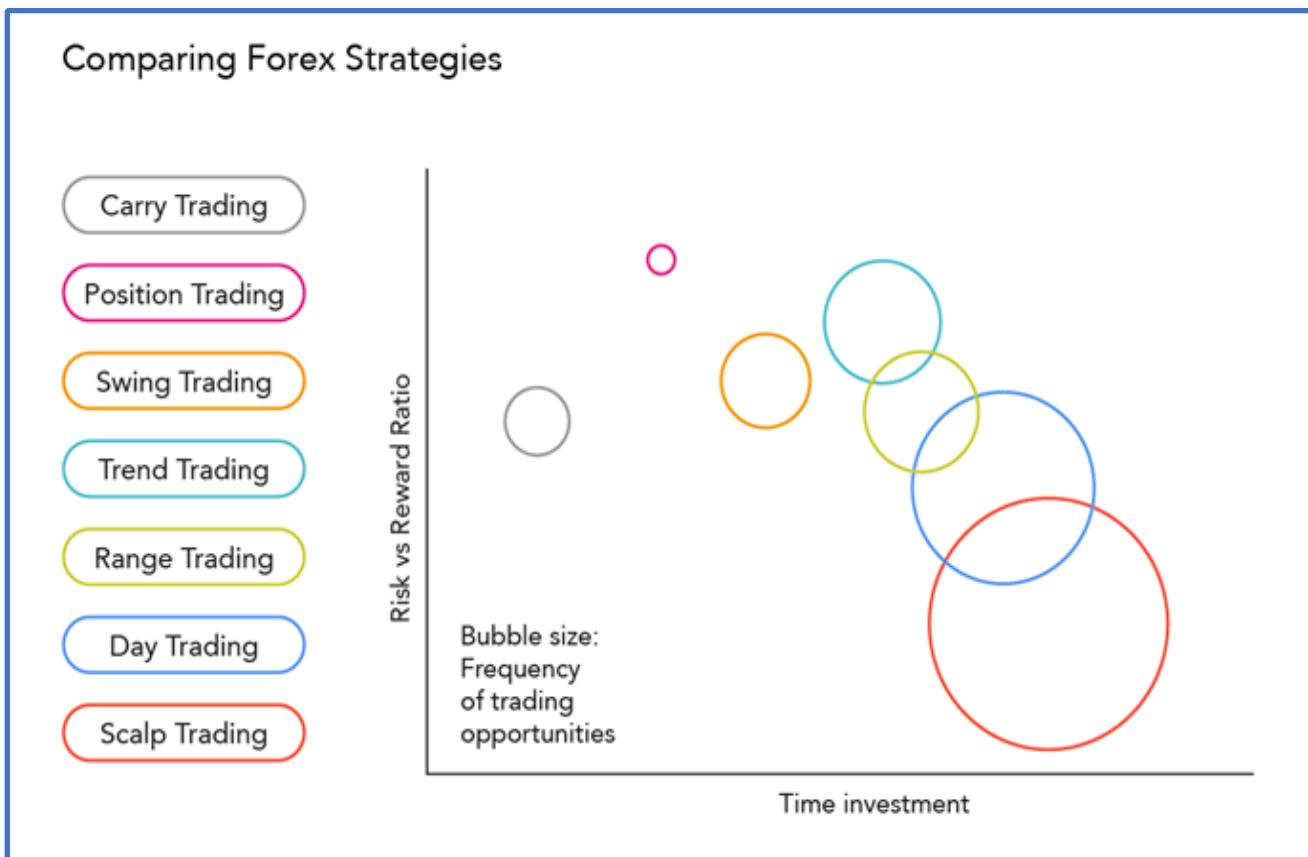
Forex strategies can be divided into a distinct organisational structure which can assist traders in locating the most applicable strategy.

FOREX TRADING STRATEGIES THAT WORK

Forex trading requires putting together multiple factors to formulate a trading strategy that works for you. There are countless strategies that can be followed, however, understanding and being comfortable with the strategy is essential. Every trader has unique goals and resources, which must be taken into consideration when selecting the suitable strategy. There are three criteria traders can use to compare different strategies on their suitability:

1. Time resource required
2. Frequency of trading opportunities
3. Typical distance to target

To easily compare the forex strategies on the three criteria, we've laid them out in a bubble chart. On the vertical axis is 'Risk-Reward Ratio' with strategies at the top of the graph having higher reward for the risk taken on each trade. Position trading typically is the strategy with the highest risk reward ratio. On the horizontal axis is time investment that represents how much time is required to actively monitor the trades. The strategy that demands the most in terms of your time resource is scalp trading due to the high frequency of trades being placed on a regular basis.



1. PRICE ACTION TRADING

Price action trading involves the study of historical prices to formulate technical trading strategies. Price action can be used as a stand-alone technique or in conjunction with an indicator. Fundamentals are seldom used; however, it is not unheard of to incorporate economic events as a substantiating factor. There are several other strategies that fall within the price action bracket as outlined above.

Length of trade:

Price action trading can be utilised over varying time periods (long, medium and short-term). The ability to use multiple time frames for analysis makes price action trading valued by many traders.

Entry/Exit points:

There are many methods to determine support/resistance levels which are generally used as entry/exit points:

- Fibonacci retracement
- Using candle wicks
- Trend identification
- Indicators
- Oscillators

Within price action, there is range, trend, day, scalping, swing and position trading. These strategies adhere to different forms of trading requirements which will be outlined in detail below. The examples show varying techniques to trade these strategies to show just how diverse trading can be, along with a variety of bespoke options for traders to choose from.

2. RANGE TRADING STRATEGY

Range trading includes identifying support and resistance points whereby traders will place trades around these key levels. This strategy works well in market without significant volatility and no discernible trend. Technical analysis is the primary tool used with this strategy.

Length of trade:

There is no set length per trade as range bound strategies can work for any time frame. Managing risk is an integral part of this method as breakouts can occur. Consequently, a range trader would like to close any current range bound positions.

Entry/Exit points:

Oscillators are most commonly used as timing tools. Relative Strength Index (RSI), Commodity Channel Index (CCI) and stochastics are a few of the more popular oscillators. Price action is sometimes used in conjunction with oscillators to further validate range bound signals or breakouts.

Example 1: USD/JPY Range Trading



USD/JPY has been exhibiting a prolonged range bound price level over the past few years. The chart above illustrates a clear support and resistance band which traders use as entry/exit points. The RSI oscillator demonstrates timing of entry/exit points as highlighted by the shaded blue and red boxes – **blue: overbought** and **red: oversold**.

Range trading can result in fruitful risk-reward ratios however, this comes along with lengthy time investment per trade. Use the pros and cons below to align your goals as a trader and how much resources you have.

Pros:

- Substantial number of trading opportunities
- Favourable risk-to reward ratio

Cons:

- Requires lengthy periods of time investment
- Entails strong appreciation of technical analysis

3. TREND TRADING STRATEGY

Trend trading is a simple forex strategy used by many traders of all experience levels. Trend trading attempts to yield positive returns by exploiting a markets directional momentum.

Length of trade:

Trend trading generally takes place over the medium to long-term time horizon as trends themselves fluctuate in length. As with price action, multiple time frame analysis can be adopted in trend trading.

Entry/Exit points:

Entry points are usually designated by an oscillator (RSI, CCI etc) and exit points are calculated based on a positive risk-reward ratio. Using stop level distances, traders can either equal that distance or exceed it to maintain a positive risk-reward ratio e.g. If the stop level was placed 50 pips away, the take profit level would be set at 50 pips or more away from the entry point.

Example 2: Identifying the Trend



In the simple example above, EUR/USD exhibits an upward trend validated by **higher highs and higher lows**. The opposite would be true for a downward trend.

EUR/USD Trading the Trend



When you see a strong trend in the market, trade it in the direction of the trend. For example, the strong uptrend in EUR/USD above.

Using the (CCI) as a tool to time entries, notice how each time CCI **dipped below -100 (highlighted in blue)**, prices responded with a rally. Not all trades will work out this way, but because the trend is being followed, each dip caused more buyers to come into the market and push prices higher. In conclusion, identifying a strong trend is important for a fruitful trend trading strategy.

Trend trading can be reasonably labour intensive with many variables to consider. The list of pros and cons may assist you in identifying if trend trading is for you.

Pros:

- Substantial number of trading opportunities
- Favourable risk-to reward ratio

Cons:

- Requires lengthy periods of time investment
- Entails strong appreciation of technical analysis

4. POSITION TRADING

Position trading is a long-term strategy primarily focused on fundamental factors however, technical methods can be used such as Elliot Wave Theory. Smaller more minor market fluctuations are not considered in this strategy as they do not affect the broader market picture. This strategy can be employed on all markets from stocks to forex.

Length of trade:

As mentioned above, position trades have a long-term outlook (weeks, months or even years!) reserved for the more persevering trader. Understanding how economic factors affect markets or thorough technical predispositions, is essential in forecasting trade ideas.

Entry/Exit points:

Key levels on longer time frame charts (weekly/monthly) hold valuable information for position traders due to the comprehensive view of the market. Entry and exit points can be judged using technical analysis as per the other strategies.

Example 3: Germany 30 (DAX) Position Trading



The Germany 30 chart above depicts an approximate two year head and shoulders pattern, which aligns with a probable fall below the neckline (horizontal red line) subsequent to the right-hand shoulder. In this selected example, the downward fall of the Germany 30 played out as planned technically as well as fundamentally. Towards the end of 2018, Germany went through a technical recession along with the US/China trade war hurting the automotive industry. Brexit negotiations did not help matters as the possibility of the UK leaving the EU would most likely negatively impact the German economy as well. In this case, understanding technical patterns as well as having strong fundamental foundations allowed for combining technical and fundamental analysis to structure a strong trade idea.

List of Pros and Cons based on your goals as a trader and how much resources you have.

Pros:

- Requires minimal time investment
- Highly positive risk-to reward ratio
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Cons:

- Very few trading opportunities
- Entails strong appreciation of technical and fundamental analysis

5. DAY TRADING STRATEGY

Day trading is a strategy designed to trade financial instruments within the same trading day. That is, all positions are closed before market close. This can be a single trade or multiple trades throughout the day.

Length of trade:

Trade times range from very short-term (matter of minutes) or short-term (hours), as long as the trade is opened and closed within the trading day.

Entry/Exit points:

Traders in the example below will look to enter positions at the when the price breaks through the 8 period EMA in the direction of the trend (blue circle) and exit using a 1:1 risk-reward ratio.

Example 4: EUR/USD Day Trading



The chart above shows a representative day trading setup using moving averages to identify the trend which is long in this case as the price is above the MA lines (red and black). Entry positions are highlighted in blue with stop levels placed at the previous price break. Take profit levels will equate to the stop distance in the direction of the trend.

The pros and cons listed below should be considered before pursuing this strategy. Day trading involves much time and effort for little reward, as seen from the EUR/USD example above.

Pros:

- Substantial number of trading opportunities
- Median risk-to reward ratio

Cons:

- Requires lengthy periods of time investment
- Entails strong appreciation of technical analysis

6. FOREX SCALPING STRATEGY

Scalping in forex is a common term used to describe the process of taking small profits on a frequent basis. This is achieved by opening and closing multiple positions throughout the day. This can be done manually or via an algorithm which uses predefined guidelines as to when/where to enter and exit positions. The most liquid forex pairs are preferred as spreads are generally tighter, making the short-term nature of the strategy fitting.

Length of trade:

Scalping entails short-term trades with minimal return, usually operating on smaller time frame charts (30 min – 1min).

Entry/Exit points:

Like most technical strategies, identifying the trend is step 1. Many scalpers use indicators such as the moving average to verify the trend. Using these key levels of the trend on longer time frames allows the trader to see the bigger picture. These levels will create support and resistance bands. Scalping within this band can then be attempted on smaller time frames using oscillators such as the RSI. Stops are placed a few pips away to avoid large movements against the trade. The MACD indicator is another useful tool that can be exercised by the trader to enter/exit trades.

Example 5: EUR/USD Scalping Strategy



The EUR/USD 10 minute above shows a typical example of a scalping strategy. The long-term trend is confirmed by the moving average (price above 200 MA). The smaller time frame is then used to target entry/exit points. Timing of entry points are featured by the red rectangle in the bias of the trader (long). Traders can also close long positions using the MACD when the MACD (**blue line**) crosses over the signal line (**red line**) highlighted by the blue rectangles.

With this practical scalp trading example above, use the list of pros and cons below to select an appropriate trading strategy that best suits you.

Pros:

- Greatest number of trading opportunities from all forex strategies

Cons:

- Requires lengthy periods of time investment
- Entails strong appreciation of technical analysis
- Lowest risk-to reward ratio

7. SWING TRADING

Swing trading is a speculative strategy whereby traders look to take advantage of range bound as well as trending markets. By picking 'tops' and 'bottoms', traders can enter long and short positions accordingly.

Length of trade:

Swing trades are considered medium-term as positions are generally held anywhere between a few hours to a few days. Longer-term trends are favoured as traders can capitalise on the trend at multiple points along the trend.

Entry/Exit points:

Much like the range bound strategy, oscillators and indicators can be used to select optimal entry/exit positions and times. The only difference being that swing trading applies to both trending and range bound markets.

Example 6: GBP/USD Swing Trading Strategy



A combination of the stochastic oscillator, ATR indicator and the moving average was used in the example above to illustrate a typical swing trading strategy. The upward trend was initially identified using the 50-day moving average (price above MA line). In the case of an uptrend, traders will look to enter long positions with the old adage of 'buy low, sell high'.

Stochastics are then used to identify entry points by looking for oversold signals highlighted by the blue rectangles on the stochastic chart. Risk management is the final step whereby the ATR gives an indication of stop levels. The ATR figure is highlighted by the red circles. This figure represents the approximate number of pips away the stop level should be set. For example, if the ATR reads 41.8 (reflected in the last ATR reading) the trader would look to place the stop 41.8 pips away from entry. At DailyFX, we recommend trading with a positive risk-reward ratio at a minimum of 1:2. This would mean

setting a take profit level (limit) at least 83.6 (41.8 x 2) pips away or further.

After seeing an example of swing trading in action, consider the following list of pros and cons to determine if this strategy would suit your trading style.

Pros:

- Substantial number of trading opportunities
- Median risk-to reward ratio

Cons:

- Entails strong appreciation of technical analysis
- Still requires extensive time investment

8. CARRY TRADE STRATEGY

Carry trades include borrowing one currency at lower rate, followed by investing in another currency at a higher yielding rate. This will ultimately result in a positive carry of the trade. This strategy is primarily used in the forex market.

Length of trade:

Carry trades are dependent on interest rate fluctuations between the associated currencies therefore, length of trade supports the medium to long-term (weeks, months and possibly years).

Entry/Exit points:

Strong trending markets work best for carry trades as the strategy involves a lengthier time horizon. Confirmation of the trend should be the first step prior to placing the trade (higher highs and higher lows and vice versa) – **refer to Example 1 above**. There are two aspects to a carry trade namely, exchange rate risk and interest rate risk. Accordingly, the best time to open the positions is at the start of a trend to capitalise fully on the exchange rate fluctuation. Regarding

the interest rate component, this will remain the same regardless of the trend as the trader will still receive the interest rate differential if the first named currency has a higher interest rate against the second named currency e.g. AUD/JPY.

Could carry trading work for you? Consider the following pros and cons and see if it is a forex strategy that suits your trading style.

Pros:

- Little time investment needed
- Median risk-to reward ratio

Cons:

- Entails strong appreciation of forex market
- Infrequent trading opportunities

FOREX STRATEGIES: A SUMMARY

This article outlines 8 types of forex strategies with practical trading examples. When considering a trading strategy to pursue, it can be useful to compare how much time investment is required behind the monitor, the risk-reward ratio and regularity of total trading opportunities. Each trading strategy will appeal to different traders depending on personal attributes. Matching trading personality with the appropriate strategy will ultimately allow traders to take the first step in the right direction.

ENHANCE YOUR FOREX TRADING

- If you're new to forex trading, download our [Forex for Beginners Trading guide](#).
- Register for free to view our live trading webinars which cover various topics related to the Forex market like central bank movements, currency news, and technical chart patterns.
- Stay up to date with major news events and economic releases by viewing our [economic calendar](#).

- Successful trading requires sound risk management and self-discipline. Find out how much capital you should risk on your open trades.
- We also recommend viewing our Traits of Successful Traders guide to discover the secrets of successful forex traders.