EUR/USD Trading Strategy

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Trading the EUR/USD

Like to trade the EUR/USD? So do we!

At BKForex, a large part of our trading is short term and the EUR/USD is one our favorite currency pairs to trade.

The EUR/USD is the world’s most actively traded currency pair and for many forex traders, this activity provides opportunity.

Trading Short Term can be very different from trading Long Term because short term trading usually involves getting into and out of positions quickly. Therefore when trading Short Term we try to look for:

1) Currency Pairs with greater liquidity
2) Time Zones with more activity

Liquidity and activity helps to drive currency movements, which is what we want for our day trades.

While liquidity can depend on the broker, most offer the greatest liquidity and tightest spreads on the EUR/USD.

As for time zones, the London and U.S. trading sessions have the most activity making it an ideal time to trade short term strategies.

In our experience, short term trading is the most effective between 4am to 12pm ET or 9 to 17 GMT.
Decline in Volatility

There are many different ways to trade the EUR/USD but over the past year, the decline in volatility in the Forex market has made range trading more popular than trend following strategies.

The following chart shows how much 3 month EUR/USD option volatilities have fallen over the past 5 years. At approximately 8%, the volatility in the EUR/USD dropped to its lowest level since 2007. For forex traders, lower volatility can mean tighter intraday ranges and a lower likelihood of breakout or runaway moves in a currency. This decline in volatility can be seen not only in the EUR/USD but all major currencies.

◊ Learn to Adapt to Decline in Volatility ◊

Volatility may remain low in 2013 as central banks continue to pump money into their economies and keep interest rates near zero. When the recovery gains momentum, volatility could increase, but between now and then, there may be more opportunities to pick tops and bottoms than to join a trend.

For this reason, we would like to share one of our favorite short term EUR/USD trading strategies - the X-Treme Fade.

Source: Bloomberg
Trading Strategy

“X-Treme Fade”
Day Trading Strategy

Type: Mean Reversion
(Picking Tops & Bottoms)

Time Frame: 15 Minute
Classification: Day Trading
Trading Strategy

“X-Treme Fade”
Strategy Tools

Indicators:

Bollinger Bands

Average Directional Index (ADX)
Indicators

Why Bollinger Bands?

Bollinger Bands is a technical analysis indicator created by John Bollinger in the 1980s. The bands consist of a moving average and a standard deviation above and below the moving average. Typically, Bollinger Bands are set at 20 period, 2 standard deviations which means that the value of the upper band is 2 standard deviations above the moving average. The lower band would be 2 standard deviations below the 20 period moving average.

In the “X-Treme Fade” strategy, we use 2 sets of Bollinger Bands:

- 20 period, 2 standard deviation
- 20 period, 3 standard deviation

In statistics, 95.45% of values are suppose to lie within 2 standard deviations of the average while 99.73% of all values are suppose to lie within 3 standard deviations of the mean. In plain english, this means that a move to the 2nd standard deviation Bollinger Band is rare but a move to the 3rd Bollinger Band is even rarer.

Our X-Treme Fade strategy looks for the EUR/USD to make an extreme move on a short term time frame (15 minute chart) by hitting the 3rd standard deviation Bollinger Band.

BUT THAT'S NOT ALL!

Before picking a top or bottom, we want to wait for the EUR/USD to close above the 2nd standard deviation Bollinger Band for a long trade and below it for a short trade - this is important because it confirms that the previous move in the EUR/USD is losing momentum.

Why Average Directional Index (ADX)?

The Average Directional Index or ADX measures strength of trend and when picking tops and bottoms, we do not want the strength of the trend to be overly strong. Therefore, we want the ADX "smoothing line" which is set at 14 to be less than 25.

\[
\text{ADX setting} = 14
\]

Look for \( \text{ADX} < 25 \)
X-Treme Fade Strategy

Long Trade Guidelines

*Only look for setups between 4am to 12pm ET (9 - 17 GMT)

1. Look for EUR/USD to close at or BELOW the 3rd standard deviation Bollinger Band
2. Wait for EUR/USD to rally and close ABOVE the 2nd standard deviation Bollinger Band
3. Check to see if ADX < 25

◆ If #2 and #3 are true, Buy EUR/USD ◆

4. Place Stop* at 15 pips
5. Close half of position at +15, move stop on rest to breakeven (initial entry price)
6. Trail Stop on remainder of position by 15 pips

*Stops can be subject to slippage by broker
Long Example #1

Here's an example of a successful long trade in the EUR/USD.
Here’s another example of a successful long trade in the EUR/USD.
Long Example #3

Not all trades will work out which is why it is important to have a stop. Here’s an example of a failed EUR/USD long trade.

*Stops are subject to slippage by broker
X-Treme Fade Strategy

Short Trade Guidelines

*Only look for setups between 4am to 12pm ET (9 - 17 GMT)

1. Look for EUR/USD to close at or ABOVE the 3rd standard deviation Bollinger Band
2. Wait for EUR/USD to fall and close BELOW the 2nd standard deviation Bollinger Band
3. Check to see if ADX < 25

◆ If #2 and #3 are true, Sell EUR/USD ◆

4. Place Stop* at 15 pips
5. Close half of position at +15, move stop on rest to breakeven (initial entry price)
6. Trail Stop on remainder of position by 15 pips

*Stops can be subject to slippage by broker
Here's an example of a successful short trade in the EUR/USD
Short Example #2

Here’s another example of a successful short trade in the EUR/USD
Not all trades will work out which is why it is important to have a stop. Here’s an example of a failed EUR/USD long trade.

*Stops are subject to slippage by broker*
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