MARK HELWEG

FOREX RANGE TRADING

with MACD and ValueBars℠

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The Idea behind the Strategy

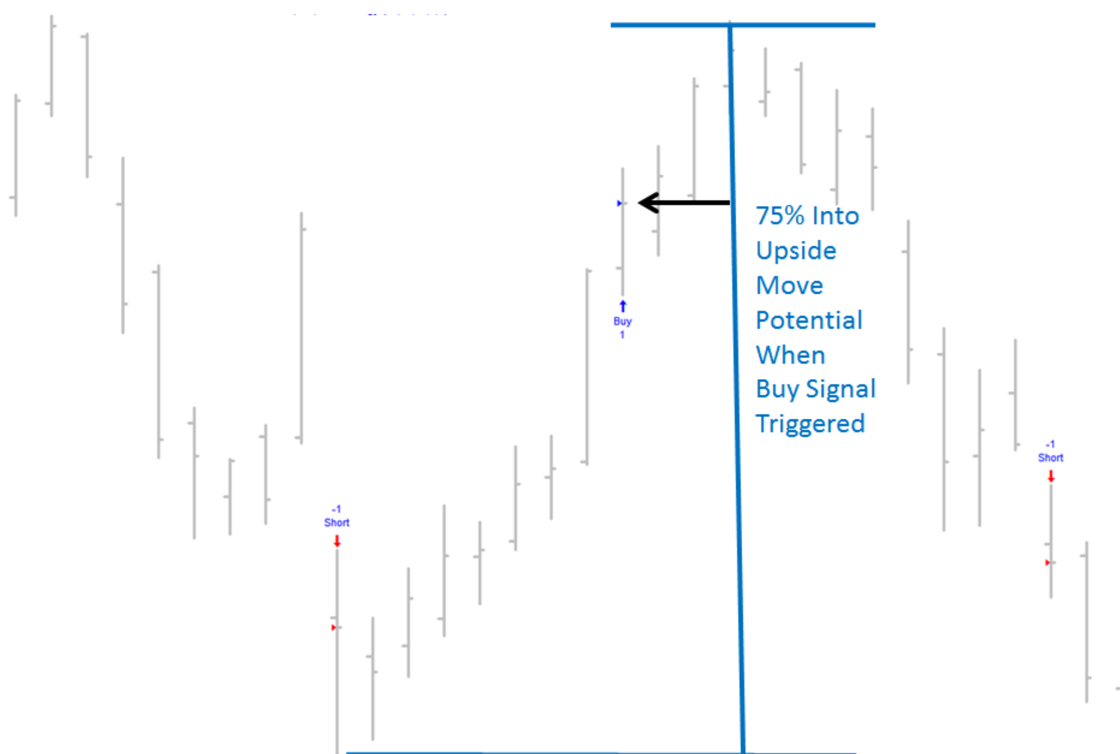
I was looking at a price chart of the NZDUSD cross during a choppy, sideways period and I was hesitant to dismiss this type of market as being untradeable. Surely there were some trading opportunities in this environment that I was overlooking.

We bring a lot of psychology into trading from our everyday lives and this can easy limit our thinking about making money in certain market environments. For example, think about the conditions that compel us to make a positive decision to take action. Unless we have been sold something by a magnetic

personality that we absolutely don't need, like a set of encyclopedias, we typically follow a process in making decisions.

When we are ready to make a positive buying decision, we typically need to see some confirming data about the item we are purchasing – like a car driving well on a test drive. We typically need positive confirmation to take action.

Unfortuantely, when we bring this thinking into trading, this translates into needing to see the market move in the direction which we are looking to trade. If we are looking to buy, we want to see a market move higher in order to confirm our opinion. If we are looking to sell, we often want to see a market selloff before we initiate our short position. This need for positive confirmation can dramatically erode our profit potential when trading and it can also cause us to buy at short-term overvalued price levels and sell at short-term undervalued price levels.



The problem is that every price move has a limited potential. In other words, most directional price moves only move a certain number of points. Therefore we have to expand our trading toolbox to include tools and indicators that can get us into trades using something other than, “directional confirmation,” if we wish to preserve the majority of our profit potential. We need to include in our trading arsenal, tools that allow us to enter and exit trades based on reasoning beyond directional confirmation. It is important to note that there is a place of directional confirmation trading strategies in trading. However, directional confirmation logic is ineffective during many types of market conditions, which compels us to seek additional trading tools that use different logic.

After really studying the NZDUSD market in the chart above, I thought that ValueBars℠ would be perfect tool to trade these choppy conditions. ValueBars℠ essentially communicate the same information that a ValueCharts® price window does. By coloring the price bars with the same color scheme as each of the five primary valuation zones in a ValueCharts® price window, ValueBars℠ communicate the valuation of a market in a similar way that a ValueCharts® price window communicates the valuation of a market. If you are not familiar with ValueCharts® price windows or ValueBars℠, visit www.ValueCharts.com for more information.

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Trading Rules

As I began to apply some of my different trading indicator to the NZDUSD cross in order to try and identify a potential trading strategy that could profit in the choppy conditions (see first NZDUSD chart), I stumbled upon what seemed like a very promising strategy. After applying ValueBars℠ and a MACD to the NZDUSD price chart, I began to see a pattern emerge. By using the MACD as the filter and by using the ValueBars℠ indicator for entry and exit signals, I observed that the choppy market conditions were perfect for what I will call, "Value Range Trading."

Here are the trading rules for this strategy:

① Trade in the direction of the MACD Blue Indicator Line. If the blue MACD indicator line is rising, look to buy. If the blue MACD is falling, then look to sell short.

② Use ValueBars^{SM} for entry signals. Buy at Moderately Undervalued price levels (lower yellow bar segments) and sell short at Moderately Overvalued price levels (upper yellow bar segments).

③ Use ValueBars^{SM} for exit signals. Exit long positions when prices reach Moderately Overvalued price levels (upper yellow bar segments) and exit short positions when prices reach Moderately Undervalued price levels (lower yellow bar segments).

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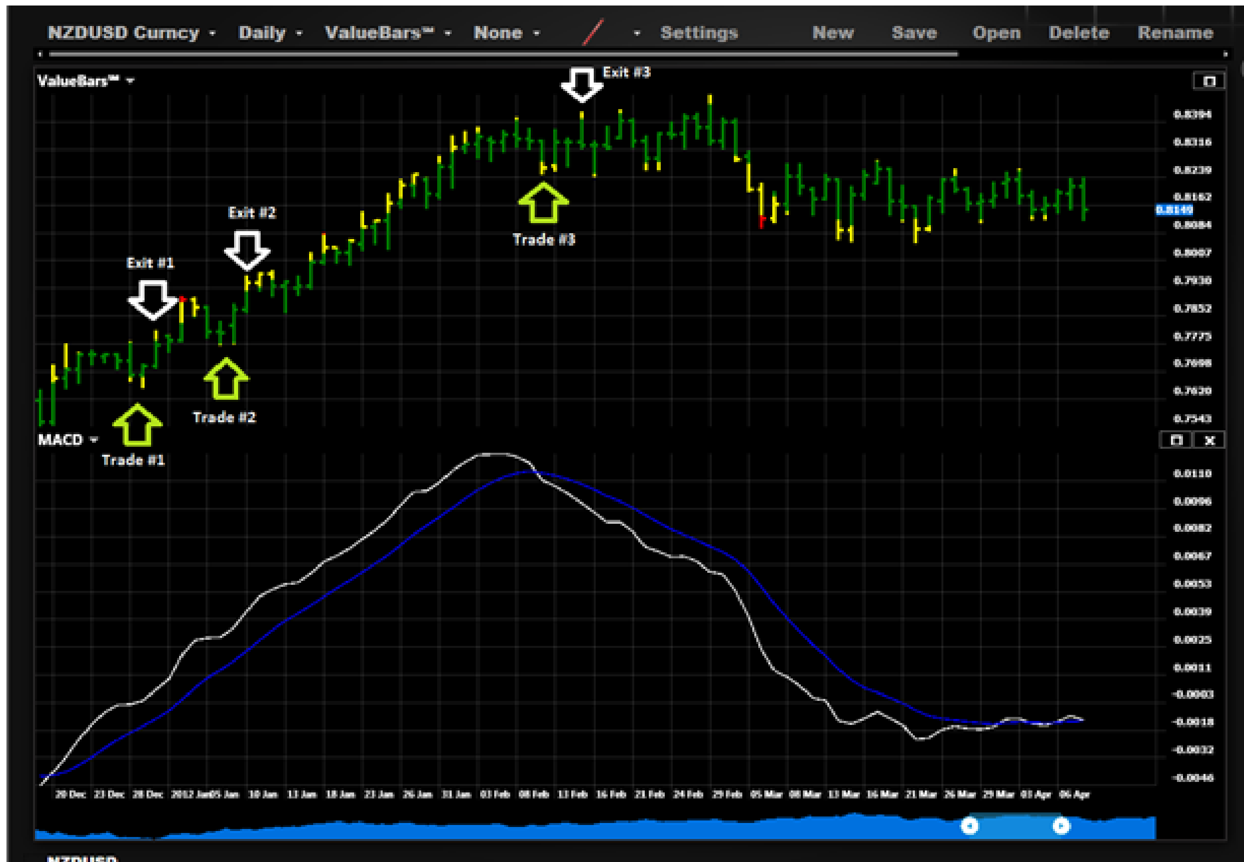
Trading Results

Trades #1, #2, and #3 in the chart below were all profitable buy signals as it turned out. The blue indicator line in the MACD was heading higher and when prices corrected down to the moderately undervalued price levels according to ValueBars^{SM}, long trades were initiated.



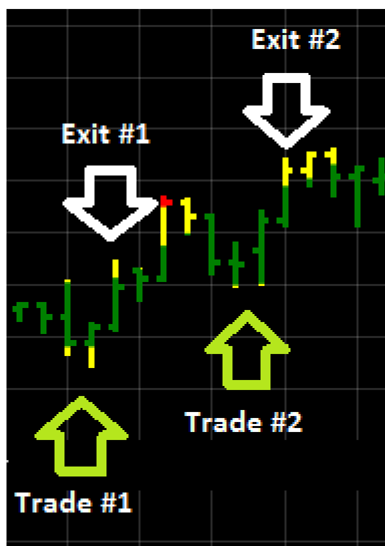
It is important to note that similar to any trading strategy, there is no guarantee that this strategy will make money going forward. I have found it to be an excellent approach to trading choppy periods like the one showcased by the NZDUSD cross and in other choppy periods similar to the one above.

We can see that the first three trades are located before the start of our choppy period referenced earlier in the first NZDUSD chart. However, I wanted to make sure that this strategy would work both before and after the choppy period.

According to Rule #1, we want to trade in the direction of the blue MACD indicator line. We can see that this line is rising in the first part of the chart above, so we are interested in looking for Buy Signals.

Rule #2 states that we buy when the ValueBars℠ are trading in the Moderately Undervalued (for Buy Signals) valuation zone. Note that we are using an analysis period of 5 bars for our ValueBars℠ indicator.

Lastly, Rule #3 states that we exit our long position when ValueBars℠ are trading in the Moderately Overvalued valuation zone.



Trade #1 in the chart above traded in the moderately undervalued valuation zone (which triggered our Buy Signal) and then, on the following day, traded in the moderately overvalued valuation zone (which triggered our Long Exit Signal). Trade #2 did the exact same thing, except the entry price bar barely traded within the moderately undervalued valuation zone, which represented less risk for the trade.

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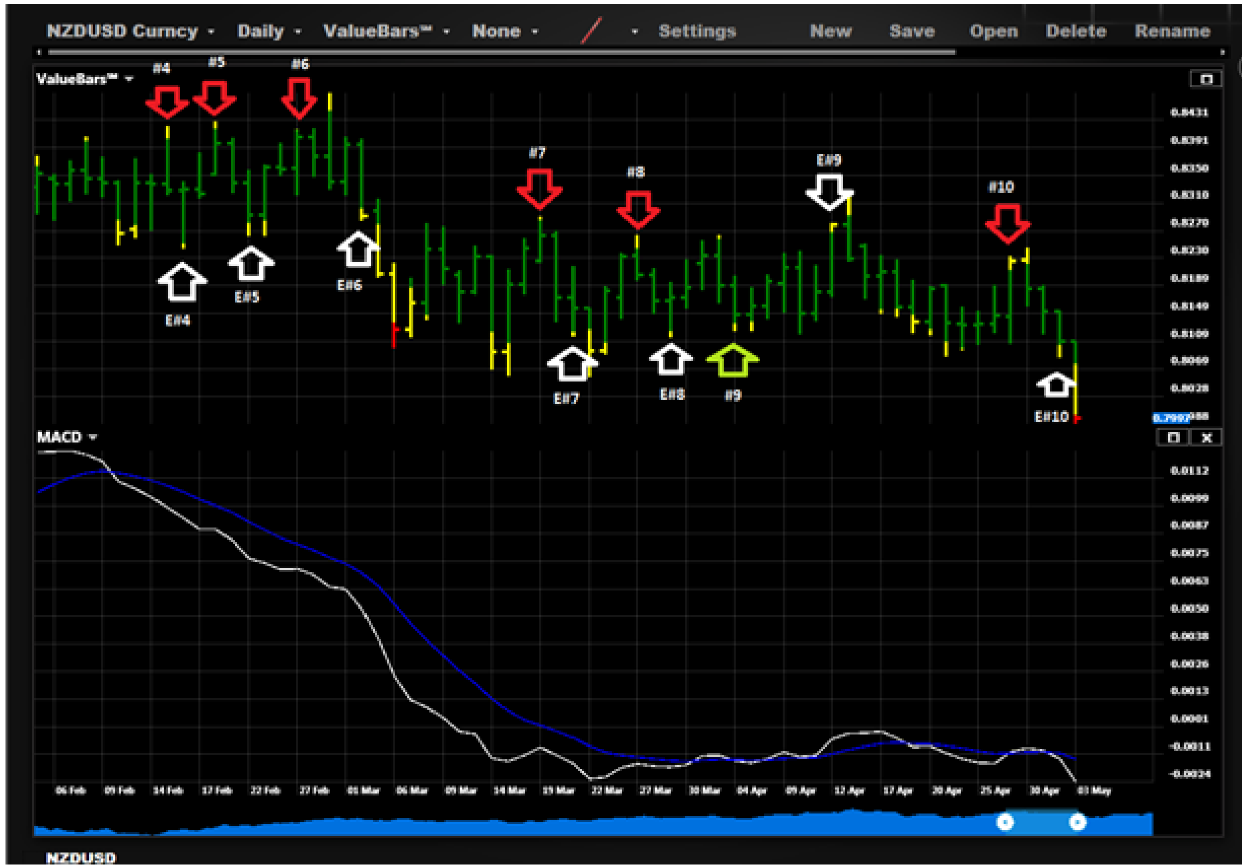
Similar to Trades #1 and #2, Trade #3 in the chart above traded in the moderately undervalued valuation zone (lower yellow bar segment) and then, after three days, traded in the moderately overvalued valuation zone (upper yellow bar segment).

Notice in the chart below that the blue MACD indicator line began to turn down after Trade #3. This means that we were then looking for sell signals from that point on until the blue MACD indicator line turned upward again. When selling short, we are using the exact same logic as the Buy Signals except for entering and exiting in the opposite value zones.



We can see that the next six trades contained mostly short signals with one long signal in the mix as well. These trades worked out well as the NZDUSD cross continued to experience choppy conditions.

This example trading strategy represents one way to trade in choppy market conditions using value-based entries and exits along with a MACD filter. We did not touch on risk management in this example. Every trade placed in the markets should always utilize a risk management stop.

Managing risk is critical to long term trading success. In general, stop placement should be between 0.5% to 3% of the entry price level. We must remember that there is a bit of an art and science to stop placement. Take time to review similar market conditions in the past for the market that you are looking to trade in order to find the appropriate stop placement level.

For long positions, the risk management stop should be placed below the entry price. The following formulas should be used to calculate risk management stop placement levels for both long and short stops.

Long Position Risk Management Stop Placement
Entry Price – (Entry Price * N%)

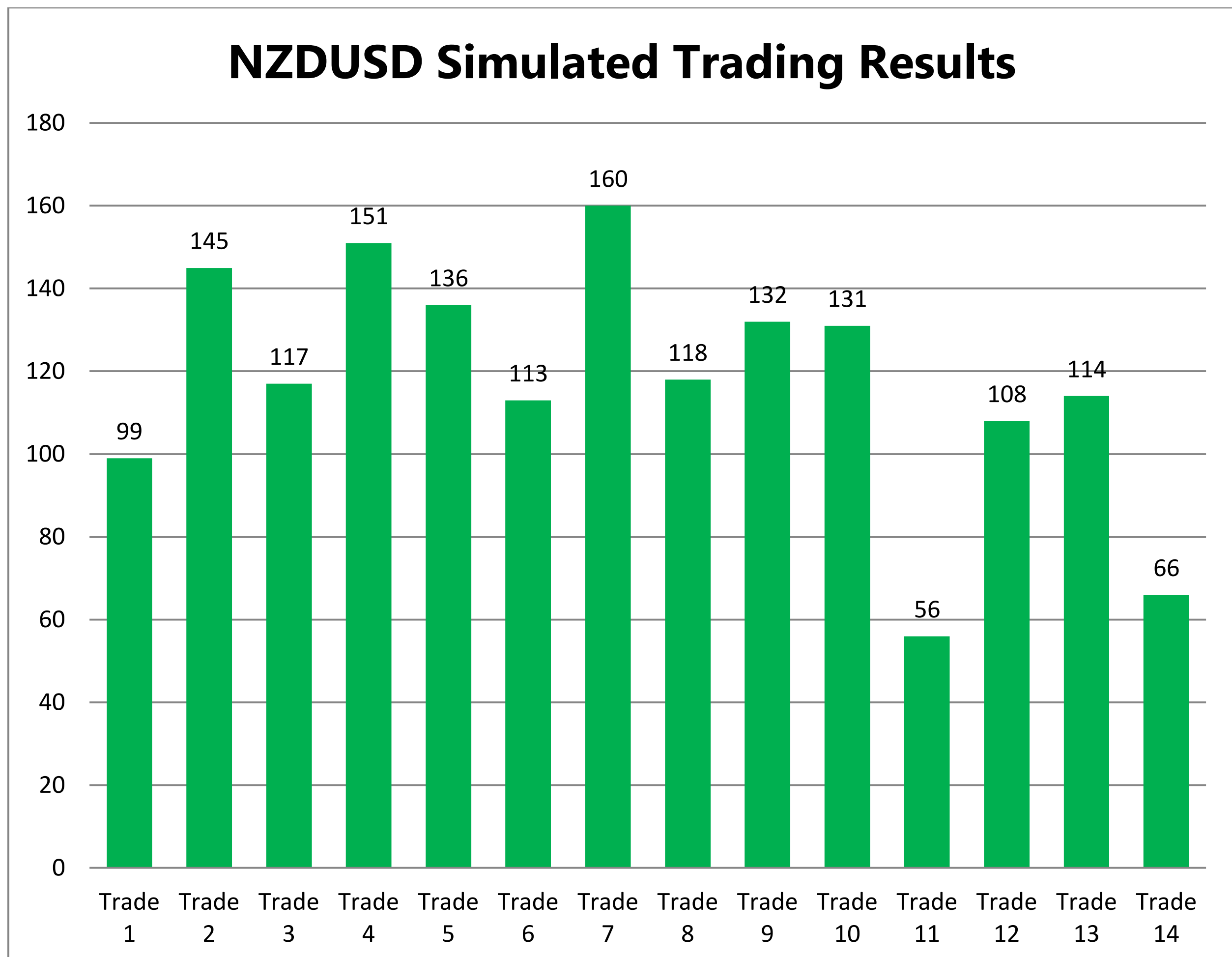
Short Position Risk Management Stop Placement
Entry Price + (Entry Price * N%)

Note: N% can in general be between 0.5% to 3% of the entry price level.

The other subject that we did not address is our selection of the 5 bar analysis period for the ValueBars℠ indicator. The analysis period range for any ValueCharts® indicators, including ValueBars℠, should be between 5 bars to 50 bars. The ValueCharts® market analysis tools operate best within this analysis period range.

We selected the 5 bar analysis period for this example because we wanted to view the shortest-term market valuation, which is more reactive and offers us more trading opportunities. For a longer-term perspective of market valuation, we could choose an analysis period of 10 bars, 14 bars, or even 21 bars. Visit www.ValueCharts.com to learn more about the ValueCharts® indicator suite, including ValueBars℠.

Results



The results above are not meant to suggest that this strategy cannot lose money, because it can. Past performance may not necessarily be indicative of future results. The trade-by-trade results above are simply provided to demonstrate that Value Range Trading can be another way to effectively trade the markets. Value-based trading entries and exits using ValueBars^{SM} should be another strategy

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that every serious trader should consider adding to his or her trading strategy arsenal.

ValueCharts® and ValueBars℠ have become two of my favorite trading tools. They are among the best timing tools on the market in my opinion, as they can identify precision entry and exit points in any market. I always use these trading tools in conjunction with other valid forms of technical and fundamental analysis. As with every trading tool, they increase in usefulness as the skill of the trader increases.

There is simply no replacement for hard work and discipline when seeking to become a great trader. The sweetest success in life is only accomplished by putting in the time and work. Powerful trading tools in the hands of a skilled trader can result in a significant trading edge over the broad markets. I always try to keep up to speed on new trading tools that have been developed. I do not end up using most of them, but occasionally I find a gem.

The trading examples contained in this book are hypothetical. You can find a copy of the Hypothetical Risk Disclaimer at the back of this book, which outlines the limitations of hypothetical trading examples.

Conclusion

This eBook was written to share a strategy that can be used to trade choppy market conditions. Each trader should make sure that he or she takes the time to understand the risks associated with trading in the markets in general. Don't trade with money that you cannot afford to risk or lose. The trading example outlined in the eBook was selected because it served to demonstrate the merits of the trading strategy presented. There are certainly market conditions where this strategy would not be appropriate.

Good luck trading and thank you for taking the time to read this eBook. To learn more about ValueCharts® please visit www.valuecharts.com.

Hypothetical Disclaimer:

All results are considered to be Hypothetical. Hypothetical performance results have many inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under or over compensated for the impact, if any, of certain market factors, such as lack of liquidity. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. Furthermore, only risk capital should be used for leveraged trading due to the high risk of loss involved. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses (and incur account draw downs) or to adhere to a particular trading program in spite of trading loses are important issues which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program, method or system, which cannot be completely taken into consideration with hypothetical performance results and will affect trading results and your P/L.