Five Rules For Trading Supply And Demand (2023 Update)

By PriceActionNinja.com

Are you tired of losing money with your Supply and Demand trading?

If you are, hold onto your hats…

This might just be the book that turns your trading around.

Supply and demand traders lose money for a variety of reasons.

- **Drawing** the zones incorrectly,
- **Entering** with the wrong signal,
- **Trading** the wrong zones, and so forth.

Costly mistakes, sure.

But another reason so many traders lose…
A reason few even consider a mistake…

Are you following the RIGHT rules?

Like all strategies, supply and demand has rules which govern how the zones should be traded. For example: "*only trade zones with a strong move away*" is one of the central rules everyone follows.

Almost all SD gurus and experts give out this little pearl for free.

The idea "*it's okay to trade old zones*" is another piece of free wisdom.

You probably follow many of these rules in your own day-to-day trading of supply and demand.

The problem with these rules: **they are INCORRECT**!

These rules DO NOT make sense!
These rules are at odds with how the market works.
These rules just sound good, that's all!

Following these rules results in many losing trades, not due to any mistakes you made, but because the rules themselves aren't compatible with how the forex market actually operates.

The rules guide you to trade the wrong zones, which causes you to lose money.

For S&D traders, these rules are MAJOR problem.

And it's one I suffered myself when I got started with S&D.

To help you avoid the same fate and improve your trading, I'm going to detail the **five rules** you need to **trade supply and demand like a pro trader.**

These five rules teach you to trade the zones **THE RIGHT WAY**.

They cover all aspects of trading Supply and Demand:

- **How** to find which zones to trade,
- **How** to determine strong zones from weak ones,
- **How** to trade with the trend, plus more.

These 5 rules will enable you to trade trade Supply and Demand like the pros and avoid the many mistakes and losses generated from trading SD under the wrong rule set.

So, without further ado, let's get started with rule #1…

RULE #1: A STRONG MOVE AWAY **DOES NOT** INDICATE A POWERFUL ZONE

Have you ever wondered why seemingly strong supply and demand zones often fail to cause reversals?

When I started trading Supply and Demand, I wondered this myself.

My guru at the time (Sam Seiden) claimed, in fact, insisted zones with sudden steep moves away were the most powerful; but, mine kept failing. Again, and again, these supposedly strong zones failed, and I could never understand why.

Was I drawing them incorrectly?
Was I misreading the strength of the move away?
Was I trading zones at the wrong time?

Sound familiar?

As I learned more about trading, specifically how order flow works, I realized the “experts” had it completely wrong.

The strength of a zone does NOT depend on the move away like they said.

The truth:

The strength of the zone is determined by the move BEFORE the zone formed.

To explain this, we need to talk about how a zone develops.

All supply and demand zones develop from the banks buying and selling, usually by placing trades, but sometimes from taking profits.

Whichever reason is not important.

All zones develop in the same way, under the same process.

The banks need opposing buy or sell orders to execute their actions. In other words, they need other traders, people like you and me, buying or selling at the same time in order place trades or take profits.

Banks want to take profits off a buy – other traders must be BUYING.
Banks want to enter a large sell trade – other traders must be SELLING.

Banks NEED opposing orders if they want to buy or sell.

The bigger the trades they want to enter, or the more profit they wish to secure, the more opposing orders they need entering the market.

Simple enough, right?

What does this mean for supply and demand?

The **strength** of a supply or demand zone depends on how **large** the bank's trades were, or the amount of profit they secured to cause a **zone** to form.

For example:

If the banks entered a massive buy trade, they obviously DO NOT want price to break past the point where they entered (the demand zone), as it could cause them to lose money.

This creates a powerful demand zone - because the banks don't want price to break the zone and mess up their trades.

But here is where it gets deeper:

The size of the trades the banks can place, or the amount of profit they can take, **depends entirely upon the opposing orders coming in!**

In other words: The number of people buying or selling.

The more people who selling, the bigger the buy trades the banks can place.

My point:

The strength of a zone is determined by the movement seen BEFORE the zone formed.

If the movement seen prior to a demand zone created a heavily bearish sentiment, such as a strong downtrend or significant downswing, then the demand must be a powerful zone.

Why?

Because the banks had to enter massive buy positions to overwhelm everyone selling, that's the only way price could reverse and form the zone.

Here's an example:

Before the demand zone above formed, the market had been falling for almost 2 weeks and a steep decline had just tanked the price.

What do you think most traders were here?

Buying or selling?
Selling, right?

Retail traders are selling:

1. **Because** the trend is down (everyone trades with the trend, remember)
2. **Because** a sudden steep decline has just taken place.

Remember: Steep rises/declines always incite traders to enter in the same direction.

Both the trend being down and the steep decline tells us an enormous number of sell orders are entering the market. The only way price can rise from here is if someone buys up all these sell orders.

Who's capable of doing that?

The banks and other institutional traders.

But here's the key point:

If the banks buy up all the orders, causing price to rise and creating a demand zone, the zone must be powerful. Because we know the banks had to buy a massive amount to stop price falling due to the vast number of traders selling because of the downtrend. That's the only way price can reverse and move higher.

If I move the chart forward:

After a sudden move higher, a demand zone forms.

What happens when price returns?

The market reverses, and a significant reversal gets underway, resulting in price eventually rising over 1000 pips.

Does this make sense now?
Can you see how this works?

It's not the move away which tells you the strength of the zone; although, it is a valid way to find decent zones.
It's the move **BEFORE** the zone formed which determines its strength.

If a zone forms after a long down move, for demand zones, or prolonged up-move, for a supply zone, it must be a powerful zone; **The banks had to buy or sell colossal amounts to overwhelm all the traders buying or selling.**

It's the same principle for steep price moves.

Steep moves will coerce traders into buying or selling en-masse due to FOMO (fear of missing out) giving the banks masses of orders to use, making any resulting zone extremely powerful.

Look:

Sure, this method of gauging the overall sentiment of buying or selling before a zone forms is not exactly scientific. It takes a decent understanding of order flow and how traders think to apply it correctly.

However, it is an effective way of accurately gauging the strength of a zone.

RULE #2: ONLY TRADE THE **FIRST TOUCH** OF A ZONE

Supply and Demand has much in common with support and resistance.

For a long time, I even thought Supply and Demand was just a cheap Support and Resistance knockoff.

(*Pretty funny, considering Supply and Demand has become my main strategy*)

For the most part, being similar has many upsides.

But, I have noticed something…

Many traders assume since supply and demand and Support and Resistance are so similar, price can return and reverse from zones multiple times, just like we see with Support and Resistance levels.

Have you heard this before?

While the idea sounds logical, it's just not true.

Supply and Demand zones are a **one-time use**.
Not two times, not three times, **just once**.
After price returns and reverses from a zone, **it's done**.

The probability of another reversal is significantly LOWER than the first touch and return.

Why are zones a one time use?

The reason again comes down to how the banks create supply and demand zones by buying and selling.

Let me explain…

Price returns to supply and demand zones because the banks have either:

1. **Not** placed all their trades,
2. **Not** taken all their profits,
3. **Not** closed all their open trades**.**

But here's another important point to remember:

Most of the time, the banks enter trades, take profits, or close trade in two separate shots!

For example:

Banks will enter a set of buy trades, which is the first position, then another set at a similar price as the second position. This is because banks never have sufficient orders available to enter all at once.

Banks must:

1. Enter using the current crop of orders,
2. Bring price back to the same/similar point,
3. Then enter their remaining trades using the new orders.

The only exception to this is during major trend reversals.

Banks will usually enter in four, possibly five positions, causing multiple swing highs or lows to form at similar prices (usually near a major psychological level e.g. 1.20000, 1.25000, 1.30000 etc.)

Now, how do supply and demand zones develop?

Oh yeh: from two lots.

The bank's first set of trades, or profit-taking, creates the zone.
The bank's second set of trades causes price to reverse when it returns.

See why zones can't cause multiple reversals now?

The banks have no reason to make price return and reverse after their entire position has been set.

The banks can enter a substantial portion of their position while creating the zone, and causing price to return usually completes their position. Hence, there's little reason for price to return for a "third touch."

The reversal will already be well underway.

RULE #3: ALWAYS TRADE WITH THE TREND… **ON THE TIME FRAME YOU TRADE OFF**

I know, I know, you've heard this a thousand times.

But stay with me…

I've added this rule for a reason!

Most traders think "trade with the trend" means the overall trend -
The trend on daily or weekly timeframes.

This is what all the books say, and many gurus agree.

But, here's the thing: Unless you execute trades on those timeframes, trading with the higher timeframe trend is a **MASSIVE** mistake.

It could even be the reason you're losing money.

Here's why:

The problem with trading with the overall trend rather than the trend on the timeframe you trade off: **Instead of trading WITH the trend you're really trading AGAINST the trend.**

Sound confusing?

Let me explain...

Imagine you trade on the one-hour chart; but, get your trend from the daily.

The daily shows price is in a clear downtrend, and the market has just made a new **lower low** after previously making a **lower high**.

All in all, it's clear: The daily trend is down.

Now you know the daily trend, you switch back to the 1-hour chart and begin looking for short trades from supply zones.

That's the plan, right?

Here's the problem:

On the 1-hour chart, the current trend is up.

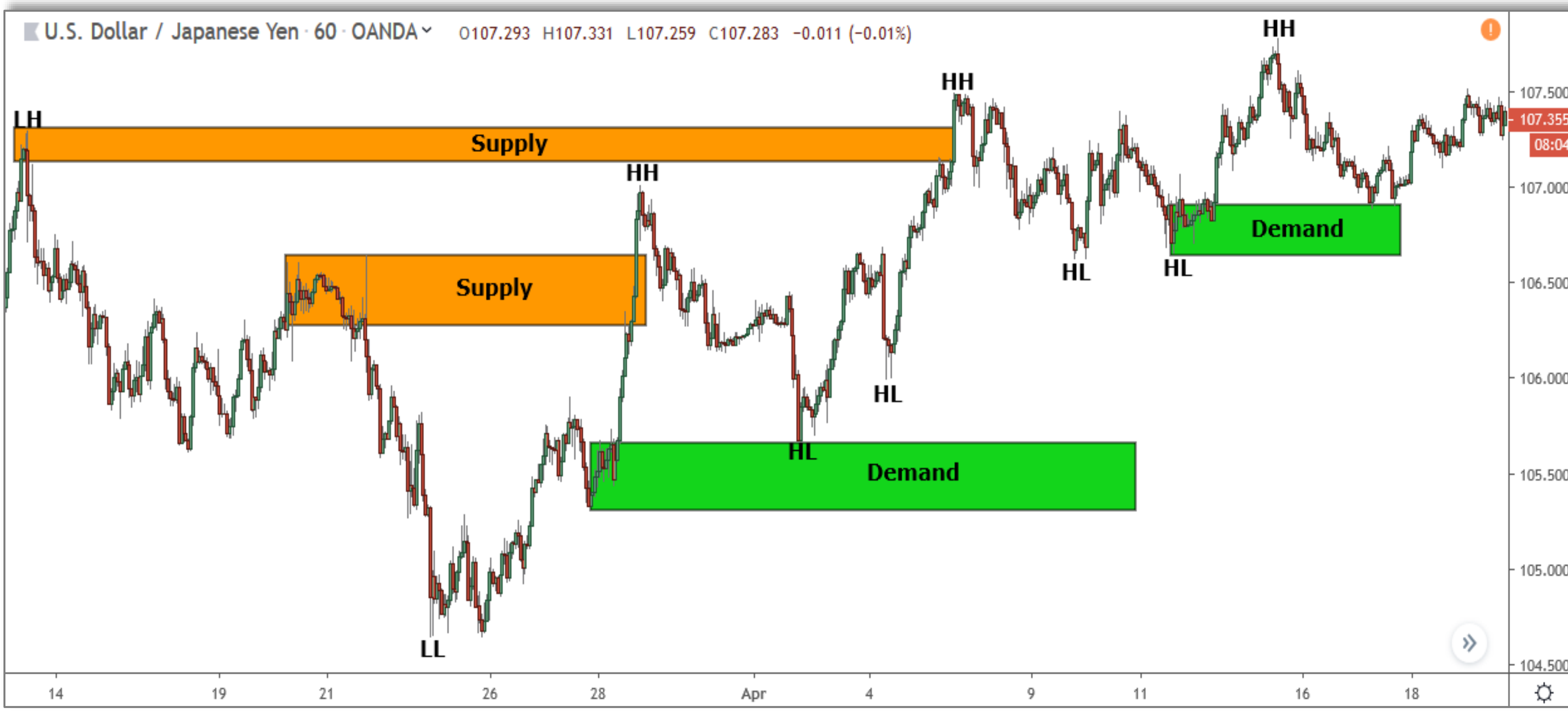
Price has just made a higher high after previously making a higher low.

This indicates the trend has changed and prices are now likely to rise.
This means you are really trading counter-trend.
This is where the problems begin.

Even though the daily trend is down, the 1-hour trend is up. So, while you are trading with the trend, **at the same time you are trading against it!**

The 1-hour trend is UP not DOWN.

Now watch what happens to the supply zones…



None of the zones result in successful, major reversals.

Not a single one!

But check out the demand zones: All the demand zones created after price reversed and printed higher highs and higher lows were successful **AND** caused two significant reversals you could've used to make money.

See the problem now?

This is the issue with trading with the overall trend.

The trend on the timeframe you trade, and the overall trend, are two very different things.

The overall trend only matters for the timeframe it exists on.

The time horizon is too great to be relevant for the timeframe you trade.

In the example, you were technically trading with the overall trend. But you were also trading against the trend on the time frame you trade off, which shows changes much faster than the higher timeframes.

The shorter timescale is too far removed from the longer timeframe.

The best way to ensure you trade with the current trend:

Always trade in the direction of the MOST RECENT higher high or lower low on your TRADE timeframe.

The newest lower low/higher high is the most up to date indication of the trend on that timeframe.

Follow these highs/lows to keep yourself on the right side of the market.

Important: Always keep the overall trend in mind to identify significant technical points and the like; but, the current trend on your trade timeframe is always the one to follow when analyzing the market.

RULE #4: AVOID TRADING RALLY BASE RALLY – DROP BASE DROP ZONES

Rally-base-rally/drop-base-drop zones have a great reputation with most supply and demand traders.

Back in the day, I would trade these zones all the time.

In fact: For a time, they were all I traded.

I didn't even bother with rally-base-drop/drop-base-rally zones.
I just stuck with the rally-base-rally/drop-base-drop zones.
I thought they were that good!

But, then I went back…

I went back and looked at my losses over a seven-month period.

And what did I find?

Other than those attributed to personal mistakes, most of my losses came from rally-base-rally and drop-base-drop zones. Now some might say I was trading them wrong, and sure, that may be true.

But then I back and did some back-testing on RBR/DBD zones.

Even accounting for my own mistakes, I found they really do not perform as well as people claim.

Sometimes they work; but, many of them fail.
Price usually just blasted straight through the zone.

I guess the question now is, **WHY**?

WHY do rally-base-rally/drop-base-drop zones NOT work as well as rally-base-drop/drop-base-rally zones?

I think there are a few reasons…

The main one, however, comes back to what I said at the beginning.

How is the strength of a zone determined?

The strength of a supply and demand zone depends on the market sentiment created by the preceding movement.

For example:

If a demand zone forms after a steep decline, i.e., a drop-base-rally, it's likely to be very powerful –

The decline made the market sentiment heavily bearish, which meant most traders were selling, which indicates the banks had to purchase massive amounts to make price reverse and create the demand zone.

This idea can also be extended:

If a zone forms in-line with the current market sentiment, like a demand zone created AFTER a rise (a rally-base-rally), the zone loses significant power.

The sentiment is already highly bullish, meaning few traders are willing to sell when price pauses and creates the zone.

With few sellers, banks can't enter large buy trades.

Think: How do all rally-base-rally/drop-base-drop zones form?

AFTER price has already been rising or falling:

- A rise in the case of **rally-base-rally zones**,
- A decline for **drop-base-drop zones**.

On the other hand,...

Rally-base-drop/drop-base-rally zones always form **WHEN** price changes from an upswing to a downswing (and vice versa). This makes rally-base-rally/drop-base-drop zones substantially weaker than their cousins.

The banks DO NOT have many opposing orders to use to execute significant trading actions.

They can't:

Enter large trades,
Take significant profits,
Close any open positions.

Here's an example...

Take a look at this rally-base-rally zone I found on EUR/USD.

According to most gurus, this RBR zone has a high chance of success.

- It has a strong move away.
- It has formed from a decent base.
- It has formed with the current trend.

But look at **WHERE** the zone formed.

The zone formed **AFTER** a steep rise, which meant the overall sentiment was bullish; many traders were buying because they assumed the rise signaled the beginning of a reversal.

If price has just surged higher, will many people sell?

Hell, NO!

This means the banks only have a few sell orders to enter buy trades with, so they can only enter tiny trades or take a small amount of profit.

The result: A weak RBR demand zone forms.

Remember: Banks wonly care about price reversing from a zone if the zone formed due to them executing significant trading actions; like entering large buy trades, or taking significant profits off open trades.

Let’s see what happens when price returns…

Price consolidates for a while then easily breaks through the zone.

Where does it reverse?

Surprise, surprise…

The powerful drop-base-rally demand zone created at the beginning of the rise we looked at earlier.

So, does this make sense?

Rally-base-rally/drop-base-drop zones **DO NOT** perform well because the zones always form **AFTER** price **has already risen or fallen**, leaving the banks few orders to enter large trades or take profits with.

- RBR zones always form AFTER price has risen.
- DBD zones always form AFTER price has fallen.

For RBD and DBR zones, that's not the case.

Rally-base-drop and drop-base-rally zones always form **AFTER** a move in the **opposite direction**:

- RBD zones always form AFTER price has fallen.
- DBR zones always form AFTER price has risen.

The opposing market sentiment gives the banks stacks of orders to use to buy or sell in large quantities.

RULE #5: DON'T TRADE OLD ZONES!

There are some killer mistakes to avoid trading supply and demand.

- *Trading zones more than once like S/R.*
- *Drawing zones from incorrect points.*
- *Trading zones inline with the overall trend.*
- *Entering without price action confirmation.*

The list goes on…

But another major problem is something many Supply and Demand traders don't even class as a mistake.

Trading old zones.

I have seen many gurus say, or imply:

"*Old supply and demand zones have the same probability of causing a reversal as new zones*."

According to them, old zones and new zones are one and the same; no difference exists between them. Both old zones and new zones have an equal chance of causing price to reverse.

Look at a chart, and it's obvious why they think this.

Old zones (seemingly) cause reversals all the time.

Go back weeks, months, or even years, and I can guarantee you'll find old supply and demand zones behind recent price reversals.

But is it really the zones causing these recent reversals?

The answer…

NOPE!

While it looks like old zones are behind price reversing, it's not the zone causing the reversal. It's something else. What that "something else" is depends on where the zone formed and what was happening at the time.

It's **NOT** the zone, it just seems like it.

If you think about **how** supply and demand zones form and **why** they work, it becomes clear why old zones can't cause reversals.

Let me explain…

The banks create supply and demand zones by executing one of three different trading actions:

- **Entering** new trades,
- **Closing** existing trades,
- **Taking profits** off open trades.

Banks execute one of these actions, then manipulate price to return to a zone; because, they could not complete the full action all at once – insufficient buy or sell orders were in the market.

For example - Banks couldn't enter a large buy trade all at once as too few sell orders were coming into the market.

But here's my question:

Why would the banks wait months or years to enter?

If the banks enter a portion of a significant buy position to make price rise, why would they now wait weeks/months/ or even years to enter the remaining portion at the same price?

By the time price returns, the whole market could've changed.

The economics could be different.
The risk profile could be different.
The market could've changed.

The market will have moved 100's or 1000's of pips away from where the banks entered their initial positions, and the points listed above may have negated their reasoning for entering in the first place.

See my point now?

Therefore: **I don't accept the idea old zones cause price to reverse.**

It just doesn't make logical sense.

It makes no sense for the banks to wait weeks, months, or years for price to return to a zone just to get some left-over trades placed.

How would they benefit from waiting so long?

If the banks want to make a profit from entering substantial trades, they'll want price to return **ASAP!**

So, how do you know whether a zone is too old?

Well, really, no sure-fire way exists.

However, I have come up with a few rules, or guidelines, you can use to determine the relevancy of a zone depending by its age.

This is relative to the timeframe which it formed.

Here's the time rules by timeframe:

- **1 min / 5 min / 15 min – 1 day**
- **30 min / 1 hour / 4 hour – 20 days**
- **Daily – 3 months.**

Keep in mind: Use these times only as guidelines, not hard rules which can never be broken.

If a zone forms within two or three bars/candles of the times above, for example, a zone 23 days old instead of 20, the zone can still offer valid trading opportunities even though it breaks the times.

It's impossible to use pinpoint accurate times in forex, so always allow a bit of leeway to account for markets randomness.

Another point:

If a zone forms within a higher time-frame zone, for example, a 1-hour zone inside a daily zone, the 1-hour zone falls under the daily/weekly rule.

The zone **DOES NOT** fall under the one-hour time rule because it exists inside the daily zone; the banks created the 1-hour zone from placing trades on the daily timeframe, not the 1-hour, so the 1-hour time rules don't apply.

Just something to remember, that's all!

The Bottom Line

Hopefully these rules have shown you the right way to trade supply and demand and cleared up a few of the long held "myths" you've been told about trading the zones from supposed 'guru's' and 'experts'.

It took me a **LONG** time to figure out these rules.
And cost me **A LOT** of money – *believe that*.

So, consider my losses to be your gains.

Before putting these rules into practice, check over some of your old trades and see if they breached the rules above.

The results will probably surprise you.

Also - Test these rules out for a while.

They won't turn you into a successful trader overnight and you'll probably have to break a few ingrained habits, like trading old zones.

But once these "new rules" start working for you...

You will see a significant improvement in your bottom line.

That, I can guarantee.

Be sure to check out some of the PriceActionNinja.com posts to learn more on the ins and outs of Supply and Demand trading.

Why You Should Avoid Rally-Base-Rally/Drop-Base-Drop Zones

Supply And Demand Trading: Profit Taking Zones Vs Trade Placing Zones

To really get inside information on Supply and Demand Trading consider the PriceActionNinja.com VIP membership.

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