

Forex Game Theory: How To Exploit Traders For Profit (2023 Update)

By PriceActionNinja.com

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Most trading techniques you see out there are built on shaky foundations - they're either untested or just don't hold water.

I've seen countless methods that sweep traders off their feet because they look easy to use. These strategies are often simple and centre around buying or selling when a clear signal appears.

But let's face it:

Forex trading isn't that simple... *far from it!*

To actually make consistent profits, you need to delve deep into the underlying mechanics of the market.

What really drives market prices.

Because it's not lines and zones on a chart which cause price changes, it's something much more obvious:

Other traders.

Traders drive prices by buying and selling for different motivations, but few videos/books/courses ever take the time to explain how this impacts the market and how to use this information in your trading.

That is, until now...

Over the following pages, I'll teach you how different groups of traders making decisions create the trends and price action we see. And how to exploit these traders to understand the market and make better decisions.

So, let's dive right in!

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Understanding The Game

Here's a harsh reality:

Forex trading is a zero-sum game.

In other words, your gain is someone else's loss.

Let's say you made £10,000 on a trade.

That cash didn't just materialize out of thin air. It came from other traders who lost money. And if you lose £10,000, well, that money just found its way into someone else's pocket because you bet on the wrong direction.

This applies to everyone in the market, whether you're a professional trader at a bank or just someone trying to make a few bucks from your home office.

In short:

The only way to come out on top is by outsmarting other traders.

Surprisingly, only a tiny fraction of traders grasp this fundamental fact about the market.

The Trend Has Been Made Up To Make You Lose Money

Now, let's address the elephant in the room - the concept of 'trend.'

I know this is going to raise a few eyebrows because most traders have the notion of 'trend' deeply ingrained in their minds.

But as we delve deeper into this book, I'll unveil why your current understanding of 'trend' is essentially designed to make you lose money.

While you're reading this, here's a brain teaser for you:

When does a movement transform into a trend? Or are all movements essentially trends?

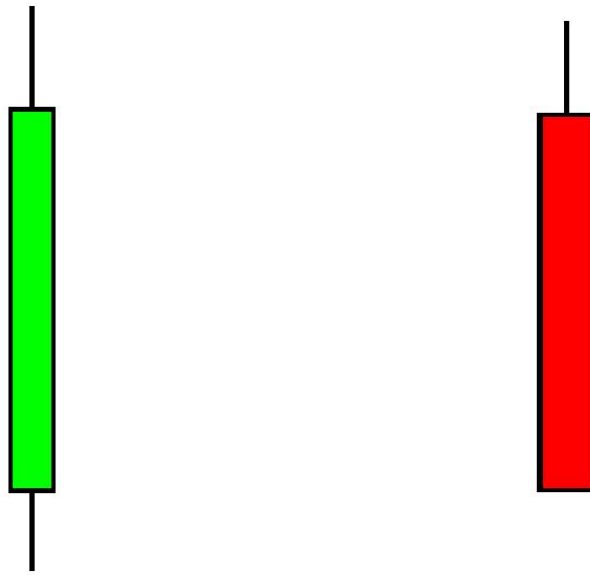
Mull over this, because it's a key takeaway from this book.

Defining A Trend

So, how do we define a trend?

This is crucial to understand why people lose money in the markets.

Most traders identify a trend using **large range candlesticks**. These candlesticks indicate a significant price change.



These candlesticks are the heartbeat of every uptrend and downtrend.

Without them, knowing the current market direction and which way price is trending would be next to impossible. Large range candlesticks play a key role in shaping traders' perception of the market.

(We'll delve deeper into this later in the book)

But for now, let's focus on another critical aspect of large range candlesticks.

FOMO (fear of missing out).

Here's the thing: When most retail traders spot a large range candlestick, they instinctively place trades following the candlestick's direction. It's like a reflex action - they see the candlestick and boom!

They're in the trade.

This behaviour isn't rooted in some sophisticated strategy. Nope. It's purely emotional, driven by a sense of urgency and fear.

Traders spot these candles and panic:

"OMG, price is falling without me!"

"If I don't jump in now, I might miss out on a massive profit!!"

Sound familiar?

And here's the interesting part - **the size of the large range candle significantly fuels this fear**. The larger the candle, the more convinced traders are about the market's movement direction.

This phenomenon is visible during news events, which often generate large range candles backed by high volume.

The volume surge?

It's the reflex traders entering, assuming the market will continue its current direction.

Now, look at these movements.



These steep moves are like a magnet for reactive traders, who interpret them as golden trading opportunities they can't miss.

And it's easy to see why - in each instance, it seems like the market is surging higher or lower.

But here's the twist: **Shortly after these movements, the market usually stalls or zips in the opposite direction.**

A bit like a cunning trap laid by the banks to trip up these reactive traders.

Here's another one...



Let's take a look at the up-move on the far right of the last image.

It's so bullish it's hard to ignore!

Many traders would have been lured into placing buy trades here, assuming price will continue its surge higher.

What would you think seeing this move?

Let's see what happens...



The sudden surge higher misleads thousands of reactive traders into buying, which the banks used to take profits off their own long trades. The result? Price tanks, and all the reactive traders lose.

Seem familiar?

And remember: Reactive traders aren't confined to any specific time frame.

Whether you're looking at a 1-hour chart or a different time frame, you'll spot these steep movements dotted with large range candles. The influence of these movements remains consistent across time frames.

It's the lure of greed at the most basic level.

The Three Phases In Every Trend

In this chapter, we'll be breaking down the three phases which create every trending movement in the market.

I'll kick things off by defining what these three phases are, as well as their purpose.

Then, we'll sift through some real-world examples where these phases are clearly visible.

Here's the deal:

Every trend is made up of three distinct phases.

These phases, like clockwork, unfold one after the other, shaping the movements within and creating the trends we see on our charts.

Heads up - my take on a trend is a movement from one point to another without any significant pullback or consolidation happening during the movement.

Long term historical trends, like those seen on the weekly or monthly, aren't significant to me due to the length of time they've been in play.

Let's dive into the phases now.

Phase 1: Imbalance

The imbalance phase is the trigger behind all major movements you observe in the market.

This phase is aptly named for what needs to happen for price to switch directions. Price can only change course if orders larger than the current ones pushing the market in its current direction enter the market.

Here's an example:



For EUR/USD to reverse and begin rising, buy orders had to enter the market which are bigger (in size) than the current sell orders. Where do those buy orders come from?

In our case, it's the banks.

The banks enter large buy trades using the current sell orders coming in, resulting in price shooting higher.

Essentially, an imbalance has happened.

The buy orders have become significantly bigger than the sell orders.

Whenever you spot a change in price direction, it's because this imbalance phase is in play. It's what initiates all major market movements, no matter which timeframe or currency pair you're observing.

Phase 2: Liquidation

The liquidation phase is the aftermath of the imbalance that occurs in the first phase.

During the imbalance phase, a set of orders larger than the ones driving the market in its current direction enter the market. This is what sparks the initial movement in every price reversal.

As price begins to move in the opposite direction, traders who had open trades in the prior direction before the reversal begin to close their trades at a loss.

This further propels price in the direction of the reversal.

Consider our example:



When price jumps higher due to the banks entering large buy trades (Phase 1: Imbalance), the traders who entered short during the previous move down start losing money.

The **further** price rises, the **larger** their losses become.

Eventually, their losses become unbearable, and they decide to close their trades.

How do you close a losing sell trade?

You must BUY back what you sold at a WORSE price.

These traders, unknowingly, become buyers and put more buy orders into the market. This causes the imbalance between buys/sells to become even greater, leading price to rise further.

Now the banks use these buy orders to take profits off their own buy trades placed earlier in the move/trend.

And how do you take profits off a buy trade?

By SELLING some of what you BOUGHT.

You need buyers to take the opposite side, otherwise you can sell.

(Beginning to see how this process comes together now?)

The key takeaway about the liquidation phase is the movement generated by traders closing losing trades heavily depends on how many traders were entered in the opposite direction price was moving before the reversal.

The more traders who had trades open in the previous direction before price reversed, the larger the movement generated by their liquidation.

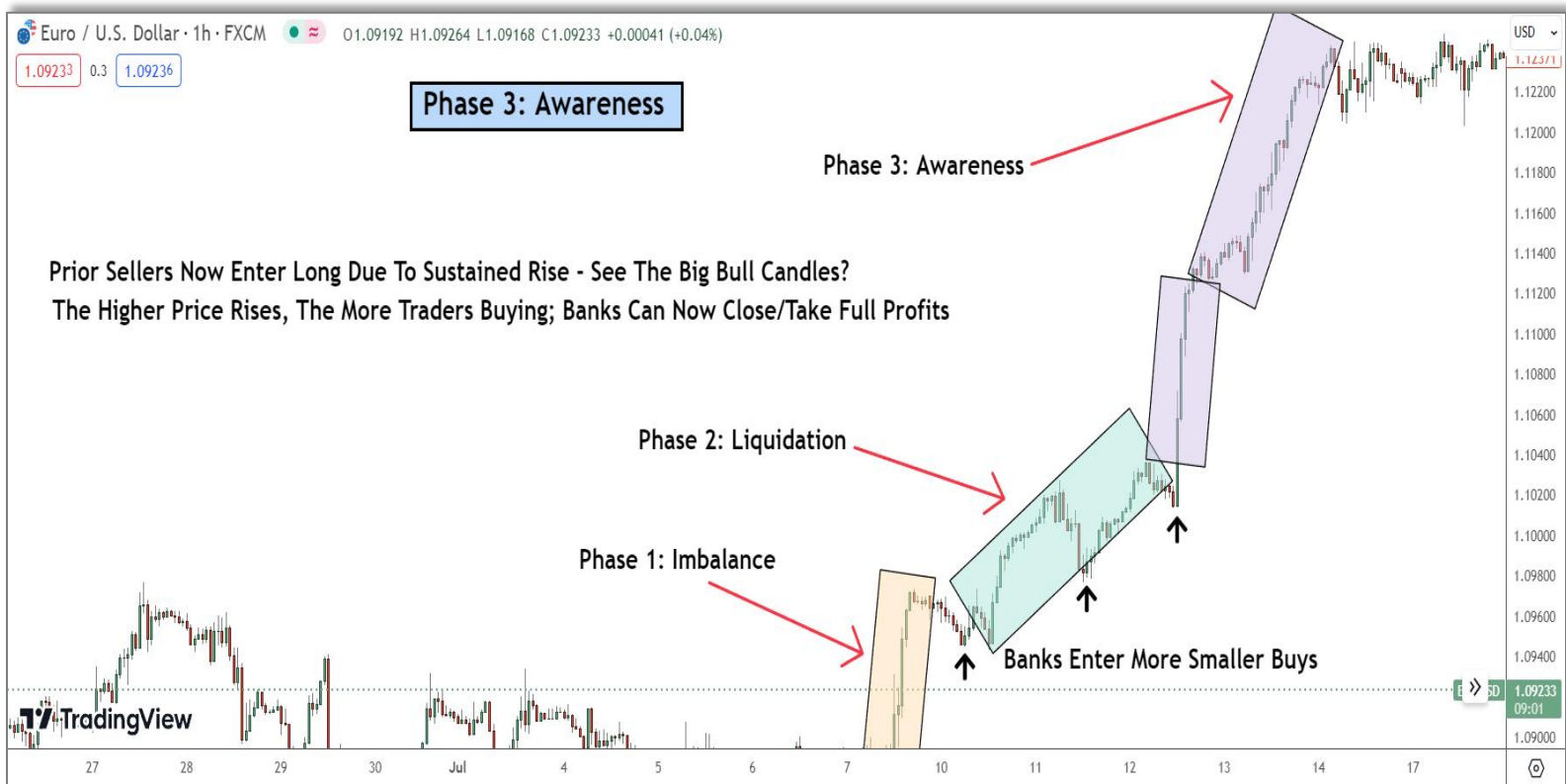
Does that make sense?

Phase 3: Awareness

The awareness phase is essentially the sum of the movements generated by the first two phases.

The imbalance and liquidation phases have caused price to move far enough to make people believe a trend or significant movement is taking place.

In our case:



As people see price rise further and further, they begin entering buy trades, assuming price will now continue rising rather than reverse.

The large bullish candles only add weight to this belief.

As these traders enter buy trades, the discrepancy between buy orders and sell orders grows even larger.

The imbalance becomes bigger.

This is when the banks will either take substantial profits and re-position (common in long trends) or close their trades and cause a reversal, which is what we see happen after the rise concludes in our example.

Quick Recap:

Phase 1 - Imbalance:

The first phase in every sustained movement or trend (Imbalance) is triggered by a set of orders entering the market that are far larger than the ones causing price to move in its current direction.

Phase 2 - Liquidation:

The second phase is driven by traders who had open trades placed before the first phase began closing their trades at a loss due to price reversing from its previous direction.

Phase 3 - Awareness:

The third phase is traders realizing a new significant movement or trend is now underway because of the movement generated by the first two phases.

The Truth About Trends



Check out the image above.

Imagine you're trying to predict which way the market will move from here. Does it seem like a massive drop is imminent?

Probably not, right?

But why?

Well, the market hasn't fallen enough to convince you a new down-trend exists.

No new lower low (the current lowest low is marked with an 'X') has formed yet, and the recent price history was bullish. So, it still seems plausible the market could rally back up to its highs, or even start consolidating.

Here's a fundamental truth: No one perceives a trend until the market has moved far enough in one direction for them to acknowledge a trend truly exists.

At the start of this book, I tossed a question at you:

"At what point does a movement transform into a trend, or are all movements considered trends?"

The truth...

All movements are trends, but not to every trader AT THE SAME TIME.

Ponder the following:

A trader who trades off the 5-minute chart doesn't care what the trend is on the daily chart. Why? His time horizon for placing and holding trades is significantly shorter than someone trading off the daily.

Similarly, a trader who trades the daily chart isn't going to stress about what the trend is on a 5-minute chart.

He's making decisions based on a completely different time horizon.

However, it's critical to realize that the decisions made by both sets of traders, based on the trend happening on their individual time-frames, will end up influencing how traders using other time-frames perceive the trend.

For example:

If a significant downward movement takes place on the 5-minute chart, numerous traders will start selling.

This wave of selling might drive the market down enough for traders who were long on the 1-hour chart to start closing their trades at a loss, causing further down movement.

Depending on its size, the movement may drive price down enough for 1-hour traders to start shorting because they believe a significant downswing is underway.

The added selling pressure could nudge price down even further, persuading traders on the daily chart to place sell trades, thinking a new trend or significant price move is happening.

This results in an even bigger price drop.

The variety of time-frames traders operate on means they all perceive the market's price action differently.

A long-sustained price decline (what we'd call a trend) on the 5-minute chart only appears as a small decline on the 1 hour and barley even registers on the daily.

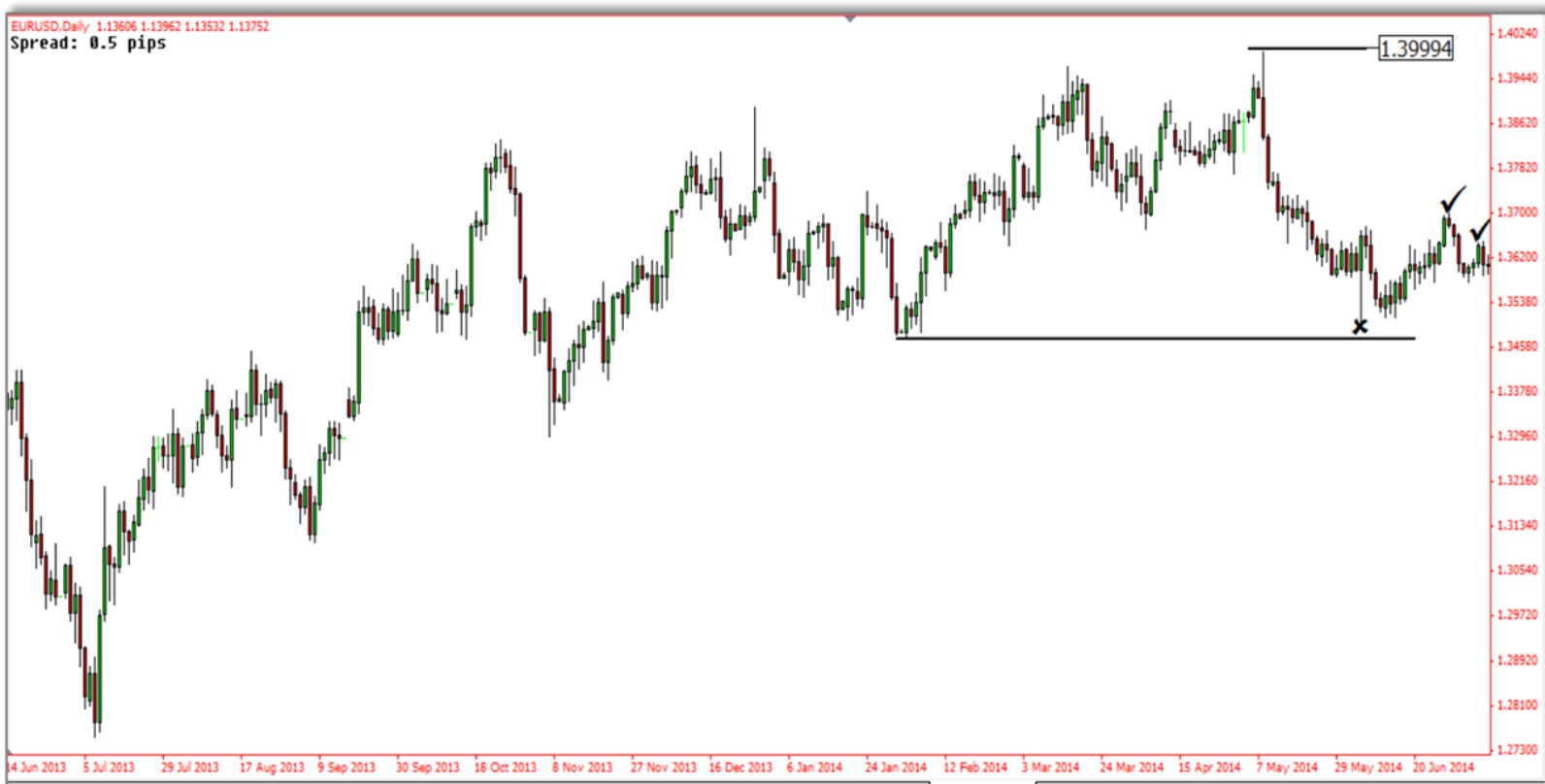
Hence, those traders don't view the move as significant.

However, if enough 5-minute traders enter short, creating a long downtrend (on the 5 min, at least) the move may become significant enough for some 1 hour traders to enter.

The movement they generate may then cause price to fall enough for most 1-hour traders to view the decline as a new trend or significant price swing.

By this time, price will have fallen enough for some daily chart traders to enter short and add more downward pressure.

The movement generated by these guys may have then caused price to fall enough for most long-term traders to perceive a new trend or large price swing is underway, causing them to enter and a real long-term trend to form.



Before the downtrend kicked off on EUR/USD, most orders entering the market were buys.

Why so?

Because the first down move from the 1.39 high is seen as a downtrend by only a specific group of traders, mainly those on lower time-frames like the 15-minute and 1-hour charts.

Most traders on daily and weekly charts wouldn't consider this a new downtrend because price hasn't fallen far enough for them to perceive a new trend exists.

Also, consider how traders on longer time frames, like the daily/weekly, probably haven't closed their losing trades when the initial downward move happened from the 1.39 high.

Their time horizon and risk tolerance explain why.

The daily trader reacts differently to price action compared to a 1-hour trader.

For example, a bearish large range candle on the daily chart would prompt reactive daily traders to place trades. However, traders on other time-frames don't perceive a bearish large range candle; they just see a minor downtrend.

The last critical point is about how professional traders take profits off their trades.

Suppose you sold 100,000 euros at the point marked with two ticks in the image.

By the time the market reaches the current low, your trade could be in a gigantic profit (let's say 1 million).

To close the trade and take profits, sell orders need be coming into the market totaling at least 1 million or more.

This situation requires a massive number of sellers, which only happens if masses of traders believe price is moving lower and enter short: **When they perceive a new downtrend is underway.**

That's why banks and other large institutions need retail traders to have a misguided understanding of the trend.

The banks need retail traders to always be placing trades late into a movement or trend because, without that, they can't take profits off their own trades, which grow in profit as a trend continues and require more traders to act as a counterparty with their buy or sell orders.

The Only Fractal Pattern In The Markets

You might've come across the term "fractals" before.

But, don't worry, I'm not talking about the fractals Bill Williams usually mentions. Instead, we're delving into the most common psychological fractal pattern in the forex market.

Let's pull up the EUR/USD daily chart...



Here's the downtrend that took place after price broke the low seen in the previous images.

Notice those blue boxes?

Each box marks a distinct downward movement in this bearish trend. Each of these follows the three phases I highlighted earlier:

- **Imbalance,**
- **Liquidation,**
- **Awareness.**

Now, let's focus on the consolidations happening between each move. These are the catalysts behind each downward shift.

When the market halts and slips into a consolidation phase, reversal traders usually believe it's because price is about to move in the opposite direction.

The trend traders, who only enter after they perceive a trend (i.e after they see price rise or fall for a long time – depending on timeframe), find themselves at a loss due to the market's counter-trend swing at the start of a consolidation.

What we end up with are two sets of buy orders flooding the market.

One lot comes from the reversal traders who are buying under the impression a price reversal is imminent.

The **other lot** comes from trend traders who enter at the end of sustained price moves closing their now losing sell trades. Bank traders exploit both sets of these buy orders to place more sell trades, pushing price in the direction of the prevailing trend.

But here's the thing:

Where these consolidations crop up within the trend can influence the banks' decisions regarding the orders generated by the trend and reversal traders.

If a consolidation forms at the start of a trend, the banks might likely use it to build positions aligned with the upcoming trend.

If consolidations appear deep into an ongoing trend, they're probably a result of bank traders taking profits off their trades.

Why is this?

As a trend ages, more people become aware of its existence, causing a surge of traders buying or selling in the same direction.

(This is the awareness phase I talked about earlier)

In the initial stages, most don't realize a new trend is underway.

Most traders often view the first downward or upward movement in the trend as merely a retracement of the preceding trend. That means most traders haven't entered trades in-line with the new trend.

Instead, they're trading based on the previous one.

In our EUR/USD downtrend example, people only started selling on any retracement or consolidation once the market had been falling for what they deemed as "long enough" as for a downtrend to exist.

The longer (and further) price declined, the more who started selling.



Take a look at the EUR/USD downtrend image.

You'll see around the mid-point two consolidations forms right next to each other, with only a tiny downward move in between. This lack of a significant downward move (or a very minor one) for multiple days/weeks extends the time price isn't trending.

For most traders, this raises their belief a reversal is near.

The longer price stays moving sideways rather than falling, the greater the number of people who think price will soon reverse and begin rising.

This means more people will lose (and close) if the market falls further.

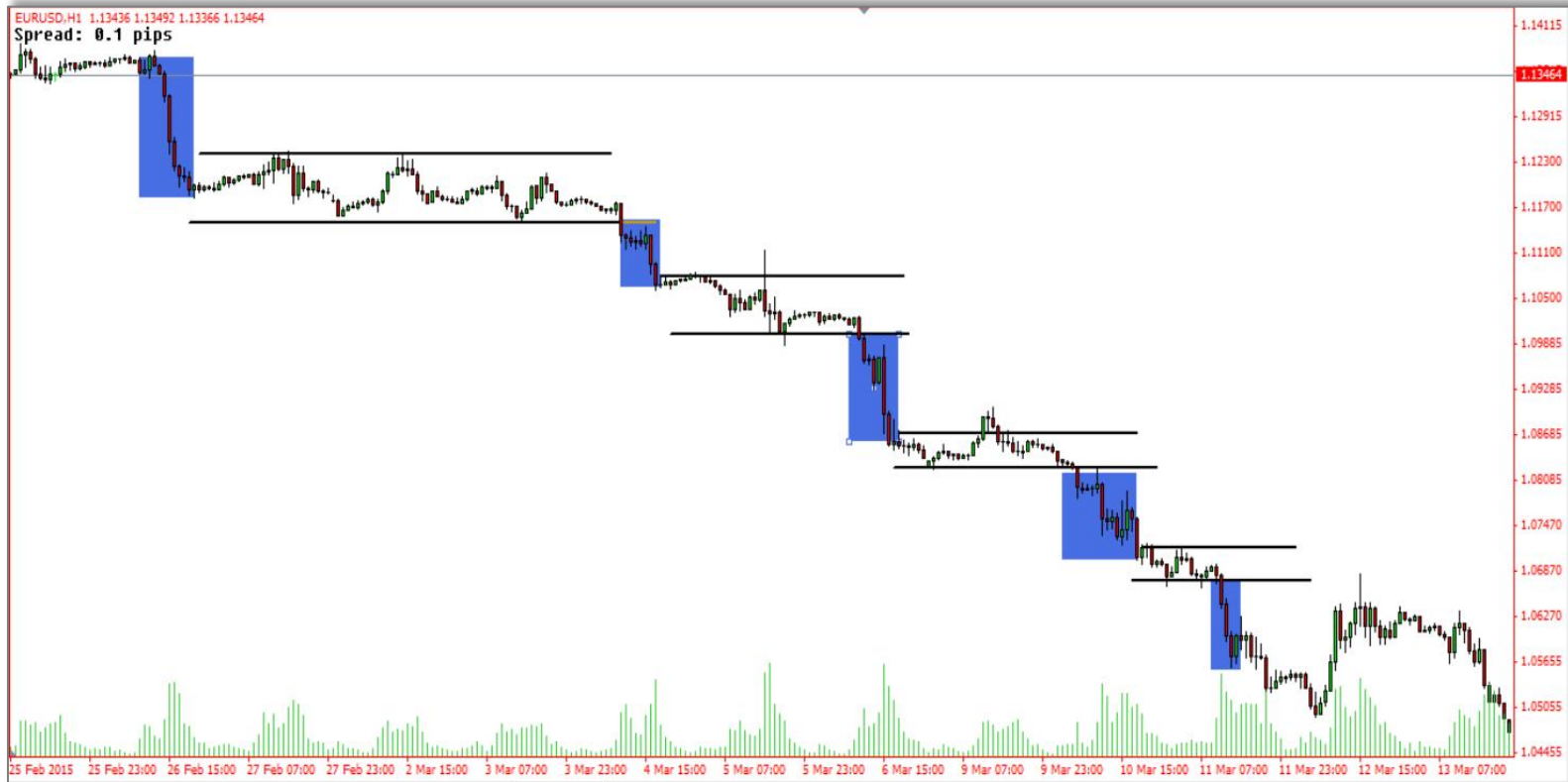
Notice the downward move following the two consolidations?

It's the steepest yet, almost equivalent to the combined size of the three preceding down moves!

This happened because there were significantly more traders closing losing long trades when price started falling after the consolidation compared to the previous ones, all because of how long price was moving sideways.

Self Similar Structure

Let's dig a bit deeper into those individual downward movements I marked in blue on the images.



Check out the image above...

It's the final downward move you can see from the previous page's image, but here we're zooming into it on the 1-hour chart, not the daily chart.

The single downward move mirrors the entire downtrend's structure - we're seeing downward movements followed by periods of consolidation.

What's happening in this overall downward move is the same as what we see during the entire downtrend on the daily chart.

The only difference?

It's affecting a smaller group of traders.

Each downward movement passes through the three phases we discussed earlier:

1. Imbalance.
2. Awareness.
3. Liquidation.

The length and duration of each decline depends on how many traders placed buy orders when price stopped falling and began consolidating or retracing. It's crucial to understand that, at this point in the downtrend, fewer traders buy when price starts to consolidate.

Why?

Because the market has clearly been in a downtrend for a long time across all time-frames.

When price has been consistently falling, traders naturally start selling on any price movement - whether up or down - believing the trend will surely continue.

Let's shift gears and look at a downward move on the 5-minute chart, part of a larger downward move seen on the 1-hour chart.



Surprisingly, even on a time-frame as small as this, the same structure holds.

The same process is happening, only it's affecting an even smaller group of traders.

The reason I've shown you these 1-hour and 5-minute chart trend structures is to illustrate how different types of traders impact each other in the market.

Lower time-frame traders - like those on the 1-minute and 5-minute charts - generate movements that affect higher time-frame traders, like those trading on the 30-minute and 1-hour charts.

Then, these traders react to the movement caused by the lower time-frame traders, stirring up enough price movement for daily and weekly chart traders to start placing trades.

This is how the market works.

It's a web of cause-and-effect relationships between all the market's traders.

Understanding Trend Traders And Reversal Traders

In this chapter, we're going to examine how trend and reversal traders make decisions.

The majority of traders utilize either a reversal strategy or a trend trading strategy to make money from the markets. While every strategy itself has different entry/exit conditions, all fall into these two categories.

By understanding these how these two types of traders make decisions, we're better equipped to predict their actions when trading.

Trend Trading

Let's start with trend trading.

Trend traders aim to profit from a movement after it has already started.

For instance, a moving average crossover only generates a signal AFTER the market has moved far enough for one average to cross the other. Price MUST move in one direction for a while for the averages to cross and flash a signal.

Would A Trend Trader Buy If The Market Was Flat?

No, because there's no trend.

A trend trader needs to see the market move in one direction for a certain length of time before he decides to buy or sell. He needs confirmation a trend actually exists, which can only happen if the market has already moved.



Would A Trend Trader Buy Now?

Yes, because now the market has moved; the trend trader sees an opportunity to potentially make money.

The important point to remember is we could be seeing these moves on a 15-minute chart, so only the trend traders on the 15-minute will have identified this movement as a trend.

Trend traders on the daily would probably see something like this:



Does this look like a new trend daily traders?

Heck NO!!

This rise is far too small to appear as a new trend.

Do you see my point now?

To the traders on the lower time frames, this movement appears as a significant up-trend. Anyone using a trend trading strategy on these lower time frames would probably enter upon seeing this movement.

For example:

On the lower TF's, this movement would probably cause an MA cross to happen.

However, to a trader using a moving average crossover on the daily, the movement above would most likely not have caused the averages to cross – price hadn't risen far enough.

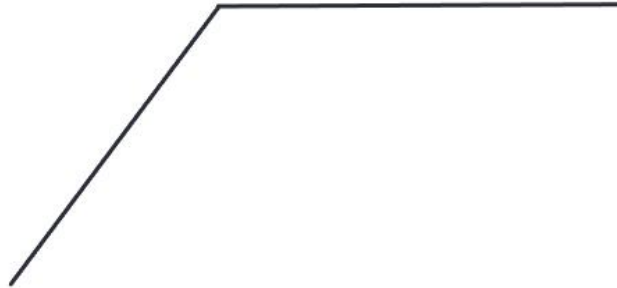
Reversal Traders

Reversal traders always aim to enter either in the direction of the current trend or counter to it.

For example:

When the market is in a downtrend, reversal traders attempt to sell against any up moves, or against the trend itself. Hence, their analysis also incorporates the concept of trend, but in a different way to trend traders.

What Would A Reversal Trader Do Here?

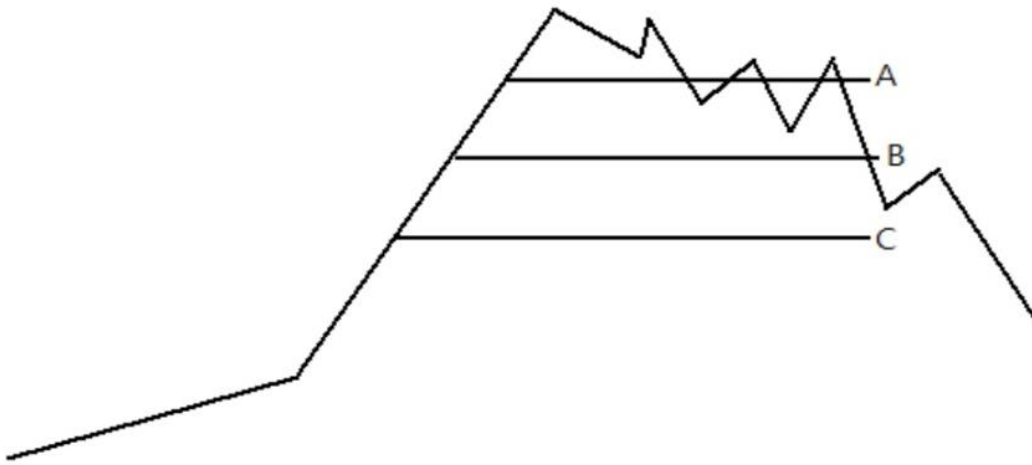


What do you think a reversal trader would do if this was all he could see?

It depends on what the previous trend was, right?

If the market been trending higher before price stalled, a reversal trader would probably enter short to capture a reversal.

If the market had been trending lower, a reversal trader would most likely view the price action above as a retracement and enter short to capture a continuation of the downtrend.



Here's a picture depicting how a typical reversal trader thinks.

First off, the market is rising, so the trader thinks price is in an uptrend.

The goal?

To spot a sweet spot to enter this trend and hopefully make some money.

So, he pulls up his charting tools, sketches lines or rectangles based on past price action, and then patiently waits for the market to swing back his way to enter his buy trade.

When price dips back to "line A," he ends up losing money.

But hey, no biggie, right?

The market still looks like it's in a "retracement" phase of the uptrend. So, he dusts himself off and fires off another trade at "line B".

Bad luck strikes again.

This time, however, the drop that breaks his line is way more substantial than the one that broke line A.

Such a drop usually includes one or more big, bearish candles which we know most retail traders use to determine the current trend. This shift prompts the trader to reconsider his prediction of the future market direction.

The sheer magnitude of this drop, compared to the first one at line A, makes him now view the market as a downtrend rather than just a retracement to the uptrend.

And so, the trader repeats the whole process of drawing lines and rectangles, but this time he's looking to go short into a downtrend rather than long into an uptrend.

The above cycle is how **ALL** reversal traders think and how they still wind up entering late into a trend rather than at the beginning.

Here's another common scenario:

Traders identify the trend on one timeframe (like the daily chart), then try to trade in the trend's direction on a different timeframe (like the 1-hour). But what they often miss is that these trends are entirely independent.

The trend could be up on the 1-hour chart and down on the daily.

But if the trader bases his trend on the daily chart, he'll keep entering sell trades on the 1-hour, thinking the daily trend will continue, even though the 1-hour trend is now going up.

Eventually, the market will move far enough on the 1-hour for the trader to identify the 1-hour trend is now the actual trend.

Then, he'll start trying to pick reversals in line with the new 1-hour trend instead of the previous one.

Another perception shift comes from losing trades consistently.

If traders keep losing money trading the same move or direction, there's a point where their beliefs about the direction will change.

For instance:

If I believe the market's going to switch to a downtrend when it's currently in an uptrend, and I keep placing sell trades against this uptrend thinking the trend's about to flip, but I keep losing, my belief that the market is going to go down will eventually fade.

At some point, I'll accept that the market isn't going down but is instead going up.

So, I'll start placing buy trades thinking price is set to climb.

The issue here is, by the time I realize the market is moving higher, the uptrend is nearing its end, meaning it's about to start reverse while I'm still placing buy trades thinking it's going to keep climbing.

See the paradox of reversal trading now?

How Time Affects Perception

Now let's touch on how time impacts perception, a topic that's rarely discussed in the forex world.

Time is a crucial element in every trader's market analysis.

For example: **The longer the market moves in one direction, the more people who start believing it'll continue moving the same way indefinitely.**

This assumption is often behind most major market crashes.

People think because the market has been rising almost non-stop for weeks, months, or years, it's bound to keep rising.

I mean, why would it fall if it's risen this far?

So, thousands of people start buying, expecting higher prices, but eventually, there's no one left to buy.

The risk-reward situation now becomes skewed to the downside, prompting people (usually banks) to start selling.

This time concept also applies to other market structures.



Take a glance at the two consolidations that occurred during the USD/JPY uptrend back in 2014.

Notice how long each of these consolidations lasted?

Combined: The market was in a consolidation phase for 273 days.

Have you ever wondered how this influences traders perspective on the market's likely movement direction?

Both consolidations essentially do two things:

First - they coax the late buyers out of their trading positions.

Secondly - they tend to make people lose sight/interest in the previous uptrend. If a consolidation lasts long enough, traders start to believe the market will keep consolidating.

Just as they often expect long-standing uptrends and downtrends to continue.

The formation of these consolidations was driven by institutions taking profits from buy trades. However, the length of time the market stays consolidated directly impacts most traders' belief the trend has ended, or the market is about to reverse.

If traders with long trades suspect the trend is over, they'll close their trades.

Here's the kicker: **Closing a buy trade means a sell order enters the market.**

And guess what?

That's exactly what the banks and institutions want.

All these sell orders enable them to place massive buy trades.

The banks will keep purchasing from these traders, knowing eventually their buy orders will outnumber the sell orders. As a result, the market will trend upwards, causing everyone who placed a sell trade during the consolidation to lose money and close their trades.

This scenario isn't unique.

You could spot a similar consolidation in any currency on any timeframe. The impact on trader psychology would be the same.

A trend cannot continue without consistent losers fuelling the banks' profits.

This can only be achieved through a retracement or consolidation.

In case of a retracement, its **length** and **speed** determine the number of traders who lose, due to what the retracement will make them believe about the future market direction.

When it comes to consolidation, **length** is critical.

The longer the market consolidates, the more traders who believe it will keep consolidating, leading to more losses once the consolidation ends.

Moreover, it's also important to consider **WHERE** retracements and consolidations occur concerning the trend.

Let's examine a retracement at the start of the USD/JPY's long uptrend.



This retracement achieved two things:

First, it caused those who bought during the initial up-move to lose money.

Then, as the market continued to fall for over 2 months, traders started viewing it as a new downtrend, prompting them to enter sell trades.

The further price falls, the more people who start selling, making the trend more apparent to traders on every timeframe.



Looking at the weekly chart, traders would think price is heading downwards.

Why?

Because the down-move seems like a continuation of the downtrend as the market didn't make a new higher high.

This situation was orchestrated by institutional traders to generate more sell orders for their massive buy trades. The banks' buying sparked the initial up-move against the prior downtrend in the first place, and their profit-taking caused the retracement we see.

The banks wanted price to fall back to where they placed their initial buy trades so they could drum up sell orders to enter more positions.

The banks are aware if they enter sizable buy trades, they'll eventually absorb all the sell orders from traders selling, and the resulting upward movement will lead those who sold during the decline to close at a loss.

This action will then trigger further upward movement, earning the banks a handsome profit on their newly placed positions.

How Do People Identify When A Trend Has Begun?

Hopefully, by now, you've caught on to why the concept of 'trend' might be designed to make you lose money.

Now, let's delve into how traders identify the start of a trend.



See the price action marked between the two lines?

Would you consider this movement as an uptrend?

When does the sideways price action, marked between the lines, start to look like a trend to traders?

When the market breaks the previous highs, right?

The higher high breaking the last high is the most common form of trend identification.

Until price breaches these highs, most traders view the market as directionless.

When the previous high is broken with bullish, large range candles – how most traders define a trend - it signals the market has an upward lean. This prompts a slew of traders to start placing buy trades, believing the higher high indicates an uptrend.



Clues as to what was likely to happen upon price breaking the consolidation emerged from the downward move pointed to by the arrow.

The almost vertical move would have thrilled reactive traders because price rose significantly in a short time span. The subsequent downward move was instigated by bank traders selling to the reactive traders who were buying.

Steep upward movements like these are often dubbed 'parabolic'.

Such movements can't last as there's no retracement or consolidation during the rise. Without a retracement or consolidation, there are no traders losing money while price is surging higher.

Remember: **A movement/trend can't continue unless there are consistent losers.**

Losses occur when price stops moving in the direction of the movement, either by consolidating or retracing.

Since the market reversed due to bank traders placing sell trades, it indicates they want price to reverse and begin falling.

If price re-enters the area where they previously sold, they are likely to sell again.

This is what typically happens soon after price breaks out from the consolidation.



The image illustrates how the banks ended up selling where they had done so five times before.

The blue line isn't a resistance level; it's there to show you where the selling took place during consolidation.

Notice how the blue line connects the swing highs of four previous downward moves, all created by the banks placing sell trades?

The parabolic rise which broke these highs led people to believe a breakout was happening. If the bank traders sell against this parabolic uptrend, they stand to make substantial gains.

Why?

Because when price falls, all the breakout traders will be forced to close their trades at a loss.

This is how you could have anticipated the market was unlikely to continue rising after breaking out from the consolidation marked by the lines.

The breakout was merely a tactic to entice more people to place buy trades, enabling the banks to place more sell trades using the buy orders generated.



Consider the start of the EUR/USD downtrend seen on the daily chart.

Nobody would have considered the market to be in a downtrend until price fell below the low marked by a line in the image.

But what happens when the low is breached?

The market begins to consolidate.

If you observe closely, you'll notice the consolidation highs align with the point where trend traders would have started placing sell trades.

This isn't happenstance.

The reason the consolidation highs meet this point is to compel the trend traders to close the sell trades they've just placed. When these trend traders who sold close their trades, it triggers buy orders in the market.

This allows institutions to place their own sell trades.

When their sell trades are placed, the market starts to fall.

Now any reversal traders who placed buy trades during the consolidation will start closing their trades at a loss, injecting sell orders into the market and propelling the next downward move.

Small Range Consolidation Setup

Let's chat about engulfing candles, the most important candlestick pattern in forex.

You've probably seen them on your charts, and maybe you've even traded them. But do you really understand their impact?

You might not realize this, but: **Engulfing candles are critical.**

These candles can manipulate traders in a major way.

Typically, people trade engulfing candles in tandem with tools like Support and Resistance, Fibonacci, Supply and Demand, or even as standalone candlestick patterns.

The trouble is, none of these methods can accurately predict when people are going to lose money and close their trades. And remember, we're playing a game where one trader's loss is another trader's gain.

We **MUST** always look for opportunities where traders will **LOSE**.

What matters about the method I'm about to reveal isn't the look of the engulfing candle itself, but comprehending what it signals to the broader market structure. Your goal is to spot events that will stun a bunch of traders into closing their trades.

Predicting a reversal before it happens?

No-can-do.

Trends begin with an imbalance phase, where one type of order outnumbers the other. This is followed by the liquidation phase, where traders who had trades open before the market reversed, start closing their trades at a loss.

Our aim?

To have our trade set up before Phase 2 kicks off.

I call this: **The small range consolidation setup.**

Sure, we can't predict a reversal before it starts, but we can certainly do our best to join the reversal before most other traders do.

If we nail this, we have a shot at a sweet trade.

Why?

Because we're entering where heaps of traders will be closing their trades at a loss, which will drive price the other way and make our trades profitable.



In the attached image, there's a marked bearish candle.

What's so special about this?

It's the candle that causes traders, who had placed buy trades during consolidation, to start closing their trades at a loss.

Prior to this candle, the traders who bought during market consolidation would have experienced small losses. However, the appearance of the bearish candle amplifies these losses from minimal to substantial.

When traders are suddenly confronted with large losses, fear often leads them to close their trades immediately to avoid losing more money.

This is our golden opportunity!

If we can spot when people are likely to close their trades, we can pocket their money.

How much we stand to gain depends on how many traders decide to exit.

Trading this structure requires you to enter on the candle that's changing the mindset of traders betting on the opposite market direction.

In the example, it's the large bearish candle.

Although this candle isn't a bearish engulfing, it marks the point where traders' small losses balloon into larger ones.

As this candle forms, the traders' losses escalate until they eventually decide to cut their losses and close their trades.

This decline pushes our short trade into profit.



Let's look at this consolidation on the daily EUR/USD chart.

The bearish candle in question again pressures any trader who bought during consolidation to consider closing their trade at a loss.

This candle's appearance on the daily chart suggests that the ensuing market drop could be much larger than if the consolidation happened on a lower time frame, like the 1-hour.

You'll see the market enters a brief consolidation phase after the bearish candle closes.

Don't sweat it.

It's just the banks taking profits, thanks to the new sell orders from traders who are closing losing longs.

Unless the market bounces back up and breaks the high of the bearish candle, there's no reason to exit your trade.

Stop Location and Rules

Let's dive into some rules to nail this strategy.

The first one is all about **timing**.

You need to ensure the candle that signals the shift in traders' psychology closes near the consolidation lows for a sell trade, or near the highs for a buy trade.

Why is this important?

It's all about trader psychology.

If the market closes at the lows or the highs, it's more likely traders will close their trades. When you think about a consolidation, it essentially has three parts: **the highs, the lows, and the middle.**

If the candle causing traders to close their trades winds up closing in the middle, fewer traders will bite the bullet as their losses aren't substantial yet.

If it closes at the highs or lows, their losses are more severe, and more traders are likely to lose since the market is further from the consolidation's middle. This middle zone is where a significant number of traders would have placed their buy or sell trades, depending on the prevailing trend.

For these small-range consolidations, the stop goes:

- ABOVE the candle's high for a SELL set-up,
- BELOW the candles low for a BUY set-up.

If your trade is spot on, you'll usually see another large-range candle form immediately following the one that led many traders to incur losses.

The Bottom Line

This book wasn't written to give you a failsafe strategy for consistently successful trades.

The primary aim of this book was to illustrate how people lose money in the markets.

I get it, this book might have been a challenging read in terms of comprehension and information density. Some readers may not have entirely grasped the concepts I've tried to communicate.

I was the same upon first learning these concepts.

But, my hope is that this book, combined with my other books/articles/courses, will equip people with the knowledge they need to consistently earn profits from the market.

Thanks for sticking with it.

Happy trading!