Forex Swing Trading with Elliott Wave

When evaluating the forex market for swing trade opportunities the focus is placed on predicting directional changes or continuations for a given currency pair. For this we rely on technical analysis.

In technical analysis, just as in fundamental analysis, there are lagging indicators and leading indicators. One of the most reliable tools used to predict forex market swings is Elliott Wave analysis. Elliott Wave analysis can be used to identify trends and countertrends, trend continuation or exhaustion and to evaluate the potential price targets of a trend.

You can apply Elliott Wave analysis to both long and short position swing trade set ups for your currency pairs.

Elliott Wave theory is named after Ralph Nelson Elliott, who concluded that the markets moved in a repetitive pattern of waves. He attributed this action to the mass psychology of the market.

Elliott concluded that the market¡¯s movement was a direct result of the mass psychology of the time and that the stock market is a fractal. A fractal is an object that is similar in shape, but at different scales. A great example of a fractal in nature is a stalk of broccoli. The stalk and the individual branches look exactly the same; just the branches are smaller in scale.

Fractals just happen to form in accordance with Fibonacci ratios. Is this a coincidence?

Elliott attributes this mass psychological move to the human trait of herding. Even though Elliott¡¯s theories were based on stock market price movements, it has been applied to evaluating Presidential approval ratings and fashion trends changes as well.

The conclusion, the market price actions are not the cause of economic growth or slow down, but the reflection of the mass psychology of investors. If the mood of the investing public is upbeat then a bull market ensues. This is counter to what most individual perceive, that because there is a bull market the mood of the investing public is upbeat.

Elliott Wave patterns follow a sequence that the markets move up in a series of 3 waves and down in a series of 2 waves. This 3 wave impulse and 2 wave corrective sequence form the foundation of the 5 Wave impulse pattern (the opposite is true in a downtrend).

The Elliott Wave Counts are as follows;

Wave 1 - Short Covering
Wave 2 - Pullback from Short Covering
Wave 3 - Major Rally Phase
Wave 4 - Institution Pause in the Rally
Wave 5 - Retail Buying

Wave 1 is usually the weakest of the impulse waves. It is a brief rally based on short covering of the bears from a previous move down. When Wave 1 is complete, the currency pair sells off, creating Wave 2.

Wave 2 ends when the market fails to make new lows. You often see dominant reversals patterns form at the end of this wave signaling the being of the rally phase or Wave 3.

Wave 3 is the longest and strongest of the impulse waves. This signals strong currency buying or selling in the direction of the trend. This trend usually starts of slowly, but tends to accelerate as it breaks to new highs above the top of Wave 1.

Like any trend, especially a strong trend a correction will occur. Traders will begin to take profits and the currency pair will retrace. This signals the beginning of Wave 4.

Again the currency pair will rally ushering in the Wave 5 rally. Wave 5 is typically supported by the retail traders and not institutional buyers (the herd) and tends to lack the momentum generated in the Wave 3 rally. This creates divergence that can be easily measured on any technical oscillator. After the currency pair breaks to new highs above the previous Wave 3 high, the rally loses steam and changes trend.

This trend change can result in either a new 5 Wave impulse pattern or a corrective in nature.

Now that we know what the Elliott Wave analysis is, how would a currency trade using this analysis look like, just as an example?

Look to Wave 5 as the most reliably tradable impulse wave. The trade sets up as follows. Look for the Elliott Oscillator to pull back between 90% and 140% of the Wave 3 high on a daily chart. This pullback should correspond to a 38%-62% Fibonacci retracement from the Wave 2 extension. This signal is the strongest when the Fibonacci retracement is between 38% - 50%.

Like any technical analysis tool you never want to employ an indicator as a stand alone analysis tool. A trigger and a confirming indicator are required as well.

Look for a trigger in candle patterns, such as Harami, Tweezers or Harami cross. There are a variety of software packages on the market that perform Elliott Wave counts and have other entry signal indicators as well.

Draw a regression channel on the Wave 4 retracement and look for a break above or below the channel as confirmation to enter the trade.

Place stops at the high of the Wave 1 advance, just below the 38% Fibonacci retracement level or where your individual trading plan dictates. Trail your stops once the currency pair has advanced past the Wave 3 high. Look for reversal candle patterns like doji, hammers, shooting stars or hanging mans for signals that the wave is about to end or stall. A typical price target is 127% retracement of the Wave 4 low.

This is just a glimpse of how Elliott Wave analysis can be deployed to enhance your forex swing trade evaluations. Look more into the Elliott Wave theory and other strategies as tools for increasing your forex swing trade opportunities.

About the Author

Todd Judkins specializes in teaching real people how to trade the Forex market for long term success by focusing on strategic, mind and money skills. He is a currency trader, educator and success coach to traders. Are you now ready to take action? To begin training with Todd for immediate, online Forex trading education visit: http://www.forexjourney.com and sign up for his FREE Forex Webinar.