Trading Pivot Points
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Pivot points are rarely understood and even rarely used by the Forex trader. The first chapter explores the question, 'What are Pivot Points?' and the reasoning behind why Pivot Points work so well and so consistently well. In the second chapter, I explain in detail how you can use Pivot Points for entry, exit, stop loss, and limit orders. The third chapter covers timing and when to trade Pivot Points.

Chapter 1, "Why Pivot Points Work"

Pivot points are super-sized resistance and support levels. They are more important than normal resistance and support levels because they're objective and it's not easy to 'read back into the data' what a trader may be subconsciously looking for. Many indicators and pattern recognition systems used in technical analysis are subjective and prone to human error. For example, two traders drawing Fibonacci lines might lead entirely opposite trades because a Fibonacci line does not inherently contain rules for objectivity. The same goes for Elliot Waves (very prone to 'oh that was the 2nd wave!') and other common systems. Common Technical Analysis indicators like Parabolic SAR, EMA and others generate so many false signals, it again becomes difficult to be objective in choosing combinations of indicators and knowing when to execute. This is why *objectivity* is the Pivot Points system's greatest strength as it takes the analysis out of the trader's hands and puts it in the capable, mathematical hands of the computer.

Why are Pivot Points so good at forecasting short-term price levels? Pivot Points are reflective of both short-term volatility and trader psychology. I usually calculate Pivot Points for the session previous plus the amount of time I'm into the next session. The longer your calculate Pivot Points, the longer you must plan to be in a trade and the wider your stops must be placed. More on stops later in Chapter 2. Calculating pivots for the last session is measuring short-term volatility and direction. Pivots also reflect trader psychology in that major pivot points are also: major Fibonacci retracements, major levels of support or resistance, and sometimes Elliot Wave retracement levels. While all three of these types of systems are quite subjective, there will be enough traders in the market using these methods to turn a pivot point into a 'battle ground' between buyers and sellers. Price action speeds up around pivot points and makes it a lower-risk entry or exit point. Remember, no system will forecast with 100% success. What we're seeking to do is lower our entry and exit risk and *raise our odds above random entry*. Research I've conducted has shown most traders actually have odds worse than random entry, because of poor money/risk management (i.e. over-trading, poor stop management, etc.) and subjectively using Technical Analysis. To model your current money/risk management system over time, download our free utility, FXChaos at our website: http://www.fabrefactum.com/fxchaos.htm.

Chapter 2, "How to Trade Pivot Points"

While there are several advanced techniques for trading pivot points, we will cover some of the most basic, and therefore, easiest to trade techniques in this chapter. Here you'll discover how to use Pivot Points as a guide for entry, exit and stop loss orders.

The first step to trading pivot points is calculating them using historical data. This can be done manually (using the public domain formula) or automatically using our software, FXSignal. We'll assume for a moment that you're using FXSignal as this simplifies all the calculations and historical data downloading. First, in FXSignal, select the time frame you want to calculate pivots for. This can be input in days (1-3), hours (1-72) or bars (1-288). My recommendation, if you're trading sessions, is to add the hours of the last session to the number of hours you're into the current session. For instance, after an 8 hour session and 2 hours into the next session, you would calculate for the last 10 hours (40 bars) of data. Enter a trending direction (important!) and calculate the pivot points.

After calculation, you will be presented with 9 pivot points and a period high and low. Enter the market in the direction of the trend and never buy within the top 3 pivots or sell in the bottom three pivots. Set your stop limit outside of the nearest opposite pivot point and plan to exit (or set a limit profit order) outside the next pivot in the direction of the current trend. Because FXSignal calculates pivots based on 15min bars, zoom in to a 5minute chart and time your entry in accordance to this faster chart's price action. This technique is the fastest and quickest way to use pivot points. Depending on volatility, you can be in and out of a trade in several hours.

For longer trades (and therefore, more pips/trade), follow the above technique, but instead of placing the stop and limit outside the next pivot point, place them two pivot points away from your entry.

Dave, an FXSignal user, writes about how he uses Pivot Points in trending markets:

> "As you know the markets either go one of three ways, up, down or sideways. Pivot Points work best in trending markets in which the currencies are, and are sort of a crude road map to the daily High and Low and support and resistance levels. The markets will typically move a certain predictable distance and then stop and consolidate for a while-- these are the support and resistance levels. These support resistance levels give you "safe" entry points to access the markets. If the market goes through one of these points it will typically go to the next level before consolidation. The reason pivot points are the safest place to enter the market as you have some ideal how far it might go before pausing and or turning around as these pivot point are also possible reversal points. And, while this is not typically good trading practices, it gives you a chance to pick daily tops and bottoms and intra day reversal points. I hope all that makes sense.
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> One does have to keep in mind the big picture of weekly and or monthly trend lines and support and resistance levels, plus keep an open ear to the fundamentals. But with those in mind and Pivot Points, trading is easy and can be profitable.
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> I made over 100 pips yesterday shorting the Euro as FXSignal called the top and was right. It could have been almost 200 pips had I held the trade over night. I made 90 pips today on the Yen and it would or could have been more it I didn't have this daily habit of sleeping during the European trading session"

Another FXSignal user combines a breakout strategy with pivot points. At a certain time of day, while prices are within the main (central) pivot point and the pivot on either side of it (depending on trend direction) he looks for a breakout. When a breakout (from within this narrow area) occurs, he executes an entry order and looks to exit two pivot points away.

There are many different ways to use Pivot Points in your intraday trading strategies. Combine them with other indicators as Pivot Points perform admirably as 'filters' for false-signal-prone indicators.

Chapter 3, "When to Trade Pivot Points"

Pivot Points are trend dependent. This means that when a currency pair is not directionally trending pivot points become less effective generate misleading signals. This is why it is important to 'eye the trend' before relying on Pivot Points for trading. Generally, the trending necessary for pivot points should be one time frame slower than what you are trading in. For instance, since FXSignal uses 15min bars it is recommended you look for trending in the 30min or 1hr charts for 2-4 times the time you are calculating pivots for. If you're calculating 40 15min bars for the pivot points, look for a trend in 40 30min or 1hr bars. Once you're assured you are in a trending market (as opposed to a ranging market), use the techniques outlined in Chapter 2. Conversely, for ranging markets, you can still employ a breakout strategy using pivot points or trade retracements, but these are advanced techniques and require experience using pivot points before we recommend you use them.

Start your trading day with FXSignal and 24 hour pivots to get a 'big picture' of the daily market. Then zoom in on a trading zone of 8-10 hours and jump into the market when pivot point levels, other

indicators or patterns confirm. Adding Pivot Points to your trading toolbox means you now have an automatically updating grid that enables you to view the market and price action objectively.

Conclusion, "How to Start Trading Pivot Points"

Because most traders will use Pivot Points on an intraday basis, it's important you have the ability to constantly and immediately update pivot points for whatever time frame you're trading with. While the pivot point algorithm is available in the public domain, don't waste time better spent in analysis on paper and pencil calculations. I wrote FXSignal for my own trading and later added features that make pivot point calculation quick and seamless. FXSignal downloads historical data for the time frame you select from a free data source. Pivot Points are calculated and output to the screen, printer or saved to disk. After purchasing FXSignal, all upgrades and feature additions are free and you have access to me and other pivot point traders for questions and suggestions.

To purchase FXSignal and start employing this powerful tool in your trading, point your browser to http://www.fabrefactum.com/howitworks.htm. Fabrefactum Software is currently developing automated execution systems and while you're there, read about our latest developments.

Information on the Author
Andrew Peters is owner of Fabrefactum Software and is currently improving his pivot point software and developing automated trading systems using technical analysis and artificial intelligence. In his spare time he enjoys mountain climbing, music and his wife Mei Ling.