

# **Desert Island Trading Method**

**Created by Scott Shubert**

**Reproduced through notes by Tao Trader**

Greetings traders,

This document is based on the training program created by Scott Shubert. Included are the notes taken from the training program, with full credit to the original author, Scott Shubert. Trades executed by anyone as a result of reading this document are at the trader's own risk. While I believe these notes will allow anyone to become a successful trader if used effectively, the dynamics of how the live market moves must also be understood. Best of wishes to all those interested in taking the time to consider these notes, and as always, pleasant trading!

## **Introduction**

This introduction considers many of the financial aspects of currency trading, including lots, risk, PIPs and leverage, and potential profit.

- A larger lot size means trading with smaller amounts of money on a regular basis.
- Every day the market moves approximately 120 pips on most currency pairs.
- For a \$1,000 account with 200:1 leverage, if you decide to risk no more than 5% of your account at any time, this means you can risk \$50.
- Each lot might cost you a \$5.00 deposit, as an example. With the leverage above you can trade 10 lots while risking 5% of your account.
- With a small account size, you will want to focus on earning \$.10 per lot traded. This means that if you traded 10 lots and you closed the trade with 20 pips profit, you will have earned \$20 – 50 pips profit. After only six months with the account listed above and at this rate, your

account would be \$10, 100. Furthermore, your daily profit would now be \$202. This is the equivalent of a job that pays \$25 per hour, 8 hours a day.

-After 1 year you would have \$108,272 in your account and your daily profit would be \$2164.

-Starting with \$1000, if you average 20 pips per day, you are consistently successful, and you risk 10% of your account, in one year you will have \$11, 521,774. The following income calculator shows how you can achieve these results, condensed for space and with the web address:

Trading Mastermind [www.ForexTradingSeminar.com](http://www.ForexTradingSeminar.com)

**Forex Trading Income Calculator**

This calculator demonstrates possible income projections based on your choice of risk, your amount of capital, the type of lot size you are using and the PIP value for major USD pairs.

The fields that can be changed are highlighted in yellow

Lot Size = The lot size you have with your account.

PIP Value (approximate) = Lot Size divided by 10,000 For instance standard lot size, 100,000 / 10,000 = \$10

Risk % or % of Capital at Risk This is the amount that you choose to risk per trade. 1.5 - 2% is recommended in the industry.

Average PIP Stop Loss - You must estimate the average stop loss size for the trading method you use.

PIPS Profit Per Day for swing trading may be considered PIPS per trade and the days may be then be considered trades.

**DISCLAIMER:** Past performance does not guarantee future results. Currency trading is risky, and is not suitable for everyone. This information is for demonstration purposes only.

Days	Lot Size	Account Balance	Risk %	\$ at Risk	Pip Value	Average PIP Stop Loss	Risk Per Lot	No. of lots traded	Number of PIPS	Daily Profit
1	1,000	\$1,000	10%	\$100	0.10	50	\$5	20	20	\$40.00
232	1,000	\$8,418,852	10%	\$841,885	0.10	50	\$5	168377	20	\$336,754.00
233	1,000	\$8,755,606	10%	\$875,560	0.10	50	\$5	175112	20	\$350,224.00
234	1,000	\$9,105,830	10%	\$910,583	0.10	50	\$5	182116	20	\$364,232.00
235	1,000	\$9,470,062	10%	\$947,006	0.10	50	\$5	189401	20	\$378,802.00
236	1,000	\$9,848,864	10%	\$984,886	0.10	50	\$5	196977	20	\$393,954.00
237	1,000	\$10,242,818	10%	\$1,024,281	0.10	50	\$5	204856	20	\$409,712.00
238	1,000	\$10,652,530	10%	\$1,065,253	0.10	50	\$5	213050	20	\$426,100.00
239	1,000	\$11,078,630	10%	\$1,107,863	0.10	50	\$5	221572	20	\$443,144.00
(12 mo) 24	1,000	\$11,521,774	10%	\$1,152,177	0.10	50	\$5	230435	20	\$460,870.00

## Currency Pairs

<u>Currency</u>	<u>Abbreviation</u>	<u>Nickname</u>
<b>Euro</b>	<b>EUR</b>	<b>-</b>
<b>Great British Pound</b>	<b>GBP</b>	<b>Cable, Sterling Pound</b>
<b>U.S. Dollar</b>	<b>USD</b>	<b>Greenback</b>
<b>Swiss Franc</b>	<b>CHF</b>	<b>Swissie</b>
<b>Japanese Yen</b>	<b>JPY</b>	<b>-</b>
<b>Canadian Dollar</b>	<b>CAD</b>	<b>Loonie</b>
<b>New Zealand Dollar</b>	<b>NZD</b>	<b>Kiwi</b>
<b>Australian Dollar</b>	<b>AUD</b>	<b>Aussie</b>

## Major pairs/currencies

Euro, Great British Pound, U.S. Dollar, Japanese Yen and Swiss Franc. These are the most commonly trades pairs.

Currencies not including the dollar are called “cross pairs,” and these including the following pairs: EUR/GBP, EUR/JPY, EUR/CHF, GBP/JPY.

The Canadian Dollar, Australian Dollar and New Zealand Dollar are considered “minor currencies,” and together they make up only 3 – 7% of trading each.

## **Soft Currencies**

Hong Kong Dollar, Singapore Dollar, Czech Koruna, New Zloty, etc. These pairs are also called exotic currencies, they are not easily traded, they lack market depth, and there may be wide spreads between the bid and ask price. Generally, there is little reason to trade these pairs, and the currencies' national economies are small and may not trend well.

Most brokers usually have at least 10 currency pairs including EUR/USD, GBP/USD, USD/JPY, USD/CHF, USD/CAD, AUD/USD, EUR/JPY, EUR/CHF, EUR/GBP and GBP/JPY. Many brokers also offer additional exotic pairs and metals, such as Gold versus the U.S Dollar. 26 pairs offered by many brokers include CHF/JPY, NZD/USD, GBP/CHF, AUD/JPY, EUR/AUD, EUR/CAD, AUD/CAD, NZD/JPY, CAD/JPY, GBP/CAD, GBP/NZD, GBP/AUD, AUD/NZD, CAD/CHF, AUD/CHF, NZD/CHF and USD/MXN.

Trading the EUR/USD is what mainstream Forex training teaches, and this training often focuses on the EUR/USD only. This pair is what more people trade than any other pair, but it may not be the best idea to only trade this pair, and the chart patterns may be distorted.

## **Trading Plan**

An ideal trading plan will include the following: a goal of demo trading, the number of pips you want to average, a win to loss ratio, risk to reward ratio, and over what time period you wish to trade including how many trades. Further considerations are listed below.

-What will be my starting capital?

-How often will I enter a trade?

-How long will the trade remain open?

-How many pips will my trades average?

-How much will I risk per trade? An example is the amount of deposit verses the number of pips in a stop loss.

**PIP-** price in points or price interest point. Pip refers to the smallest unit of price of a Forex currency pair. Example: GBP/USD price = 1.6500- the 65 represents hundredths of a cent. If the price moved to 1.6501 it moved 1 pip. Another example of this price is shown below.

**GBP/USD price = 1.6501**

**6 = tenth of a dollar**

**5 = hundredth of a dollar and tenth of a cent**

**0 = thousandth of a dollar and tenth of a cent**

**1 = ten thousandth of a dollar and hundredth of a cent**

## **Lots**

Lot size is extremely important and the number may be determined by your broker and the type of account you choose. You should refrain from asking anyone how much a pip is worth except your broker, because the pip worth depends on the type of account you choose.

**Lot-** traditionally a lot refers to one million dollars in the Forex market. Today a standard account lot size is \$100, 000; a mini account has a \$10,000 lot size; a super mini account has a \$1000 lot size. If you have a standard lot size of \$100,000 and your account is set for 100:1 leverage, this means you will deposit \$1000 for each lot you trade. If you have \$30,000 in your account (a standard lot size of \$100,000 and your account is set for 100:1 leverage) and you choose to risk 30% of your account per trade, this means you will be willing to risk \$900 dollars, which is less than the deposit for one lot. Therefore, you would need to either deposit more funds into your account or go with a different type of account.

### **Lot Size Examples**

**\$100,000 = \$10 value per pip**

**\$10,000 = \$1 value per pip**

**\$1,000 = \$.10 per pip**

These figures are generally true regardless of the leverage you have. Another way to look at these figures is that lot size divided by leverage equals price per lot.

**\$100,000 divided by 100 equals \$1000 per lot.**

An important point to remember is that your risk is based on the number of pips you are willing to go negative or the number of pips in your stop loss, **NOT** the amount of your deposit.

### **Risk Management Examples**

If 1 lot costs you \$5 and you trade with 10 lots, you risk \$50 margin; many people assume you actually risk is \$50. However, if in this trade you have a 25 pip stop loss your true risk is \$25, whereas your margin to enter the trade is \$50.

-Remember that the value of a pip is different among currencies, and these are general guidelines.

## **Forex Brokers**

When considering a Forex broker, look at the following components:

-What is the minimum account size?

-What is the maximum leverage available and is the leverage limited by account size?

-What is the broker's policy on interest rates for carry over trades? Are the interest rates displayed in the trading platform?

-Are the negative and positive interest rates comparable, or are the negative interest rates consistently twice as much or more? (If so, this broker most likely has an unethical business model that will show up in all other areas.

-Carry trades: most U.S. brokers hold trades overnight after 5 p.m. (Eastern Time), and you are charged or credited interest on any existing trades. This interest is theoretically based on the difference between the interest of the 2 currencies. However, it is not the actual interest rates that represent the difference between the currencies. Finally, holding trades overnight is advisable.

-What currency pairs are available?



- What trading platform software is used and what is it like? Is it advanced or cheesy?
- Charts should NOT be a determining factor. However, if you intend to be a professional trader, you should expect to subscribe to professional charts rather than use charts that your broker provides.
- Do not be lured by free professional charts. You will more than pay for them with the trading requirements such as 10 round turn lots per month trades. Just get your own charts and choose the best broker based on other criteria.
- Do not be lured by apparent low pip spreads or pip rebates. Brokers with the lowest pip spreads are often the ones that are the most notorious for price manipulation. In this way you pay more than you would have with a more reputable broker. PIP rebates are simply an Introducing Broker attempting to bribe you by sharing their profit, because the broker cannot offer any other legitimate reason for you to choose to trade with them.
- Choose a broker based on industry standards, reputation, how secure your funds are...etc.
- What is the company's financial strength? Given the fact that many traders lost access to their accounts when a large major broker recently filed bankruptcy, financial strength could be important. However, this broker was considered one of the stronger companies financially at the time it went under.
- Does the broker offer hedging, entry limit orders, trailing stops, etc... You may not want to do business with a broker that does not permit opening hedge trades, which will be covered later. At the time of this writing (December, 2009) Forex Hedging has been outlawed in all USA Forex accounts regulated by NFA.

- Hedging is simply having two trades open on the same currency pair in opposite directions, (buy and sell) at the same time.
- Does the broker allow trailing stops, which are stop losses that automatically move up or down as the market moves up or down?
- What country is the broker located in, and where will your funds be held?
- What seems to be the consensus about the broker's reputation with other traders? Many inexperienced traders will rave about their broker as being the best, as if it is their football team. Often these traders know nothing about any other broker. Look for legitimate reasons why a broker may be preferred over others. You might also consider having funds with brokers in several different countries.
- Consider trading with multiple brokers to minimize risk and have access to different features.
- When you see "open an account, 2 pip spread, try our trading platform," this is a clue that the broker or site may be unethical.

## **Currency Pairs**

A currency pair is quoted with the dominant currency first such as EUR/USD, with an example price of 1.4320. This means that it takes \$1.43 & 20/100ths of a cent of U.S. dollars to buy one Euro. Since the U.S. dollar is worth less than the Euro, the Euro is quoted first. The price reflects how many U.S. dollars are needed to buy one Euro. If the value of this pair were to

fall below 1.0000 the pair would need to be switched to U.S/EUR. If the EUR/USD falls in value this means the U.S dollar is increasing and the Euro is decreasing in value.

Generally, Forex brokers do not charge commission or fees on your trades; instead there is a difference between the “bid,” and “ask” price, and the difference is the “spread” you are charged. For instance, when you enter a trade in which you buy the pair you get a price that is slightly higher than when you sell.

### **Spread/Profit Example**

Suppose you have a \$1000 lot size account with 200:1 leverage (this account is sometimes called a “super mini” account). In this type of account, if you traded 10 lots and the market moved 50 pips in your favor, your profit would be \$50 minus 3 pips for the spread. 3 pips would equal \$.30 times ten lots which is 3 dollars. This means your actual profit is \$47, and the trade costs you a total of \$3. So, to get a true 50 pips of profit the market needs to move 53 pips in your favor.

### **Opening An Account**

The following are a few Forex brokers to consider when opening an account:

**FX Solutions**- broker with locations in U.S., Australia and the U.K. Low minimum accounts and high leverage available.

**Interbank FX**- claims to have straight through, no dealing desk trading. Some of these brokers are the most notorious, and legitimate brokers have been said to offer lower leverages in order to put trades into the interbank market.

**Note: These brokers are just two examples, they are not recommended as the top brokers.**

These brokers offer free downloads of their trading platforms, as do many other brokers. These platforms also have instruction manuals on how to use the trading platforms; they have live customer service online, and there are telephone numbers you can call to ask questions.

Note: A good deal of the field of technical analysis involves simply observing what the market is in the process of doing, **NOT** predicting what the market will do in the future.

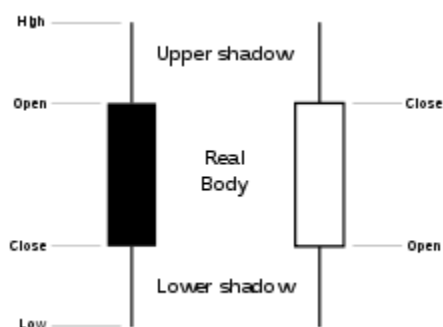
The following charting programs are effective for trading with Forex brokers:

**-Metatrader 4/5, E-Signal, Metastock, Fx Trek, IntelliCharts, Dynamic Traders.**

## Candlesticks

The following are a few examples of the various candlestick types and formations with a hyperlink: [http://en.wikipedia.org/wiki/Candlestick\\_chart](http://en.wikipedia.org/wiki/Candlestick_chart)

## Candlestick chart topics





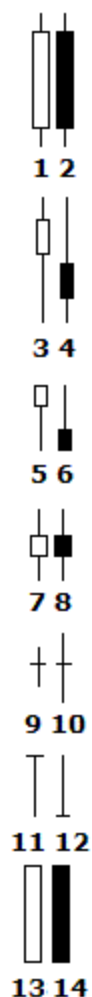
“ The basic candlestick

## **Candlestick layout**

[Candlesticks](#) are usually composed of the body (black or white), and an upper and a lower shadow ([wick](#)). The wick illustrates the highest and lowest traded prices of a security during the time interval represented. The body illustrates the opening and closing trades. If the security closed higher than it opened, the body is white or unfilled, with the opening price at the bottom of the body and the closing price at the top. If the security closed lower than it opened, the body is black, with the opening price at the top and the closing price at the bottom. A candlestick need not have either a body or a wick.

To better highlight price movements, modern candlestick charts (especially those displayed digitally) often replace the black or white of the candlestick body with colors such as red (for a lower closing) and blue or green (for a higher closing).

## **Candlestick simple patterns**



There are multiple forms of candlestick chart patterns, with the simplest depicted at right. Here is a quick overview of their names:

1. White candlestick - signals uptrend movement (those occur in different lengths; the longer the body, the more significant the price increase)
2. Black candlestick - signals downtrend movement (those occur in different lengths; the longer the body, the more significant the price decrease)
3. Long lower shadow - [bullish](#) signal (the lower wick must be at least the body's size; the longer the lower wick, the more reliable the signal)
4. Long upper shadow - [bearish](#) signal (the upper wick must be at least the body's size; the longer the upper wick, the more reliable the signal)
5. [Hammer](#) - a bullish pattern during a downtrend (long lower wick and small or no body); Shaven head - a bullish pattern during a downtrend & a bearish pattern during an uptrend (no upper wick); Hanging man - bearish pattern during an uptrend (long lower wick, small or no body; wick has the multiple length of the body).
6. Inverted hammer - signals bottom reversal, however confirmation must be obtained from next trade (may be either a white or black body); Shaven bottom - signaling bottom reversal, however confirmation must be obtained from next trade (no lower wick);

Shooting star - a bearish pattern during an uptrend (small body, long upper wick, small or no lower wick)

7. [Spinning top](#) white - neutral pattern, meaningful in combination with other candlestick patterns
8. [Spinning top](#) black - neutral pattern, meaningful in combination with other candlestick patterns
9. [Doji](#) - neutral pattern, meaningful in combination with other candlestick patterns
10. Long legged doji - signals a top reversal
11. Dragonfly doji - signals trend reversal (no upper wick, long lower wick)
12. Gravestone doji - signals trend reversal (no lower wick, long upper wick)
13. [Marubozu](#) white - dominant bullish trades, continued bullish trend (no upper, no lower wick)
14. [Marubozu](#) black - dominant bearish trades, continued bearish trend (no upper, no lower wick).”

For a thorough analysis of candlestick patterns, see “The Candle Stick Course,” by Steve Nison, which can be viewed at the following link among others: <http://www.amazon.com/Candlestick-Course-Steve-Nison/dp/0471227285>.

## Time Frames

The weekly time frame shows what is happening inside each monthly candle; the daily time frame shows what is happening inside each weekly candle; the 4 hour time frame shows what is happening inside each daily candle; the hourly shows what is happening inside each 4 hour candle; the same goes for all time frames smaller than the 1 hour chart; all of the information is the same, simply displayed in different ways.

Remember to always look at multiple time frames. The shorter the time frame the less meaningful and significant are the indicators, trends, and everything else you see. Likewise,

short term time frames have the least amount of momentum, and these time frames are primarily a chaotic noise inside of a larger picture.

## Indicators

This section is a short introduction about a few useful chart indicators (hyperlink below):

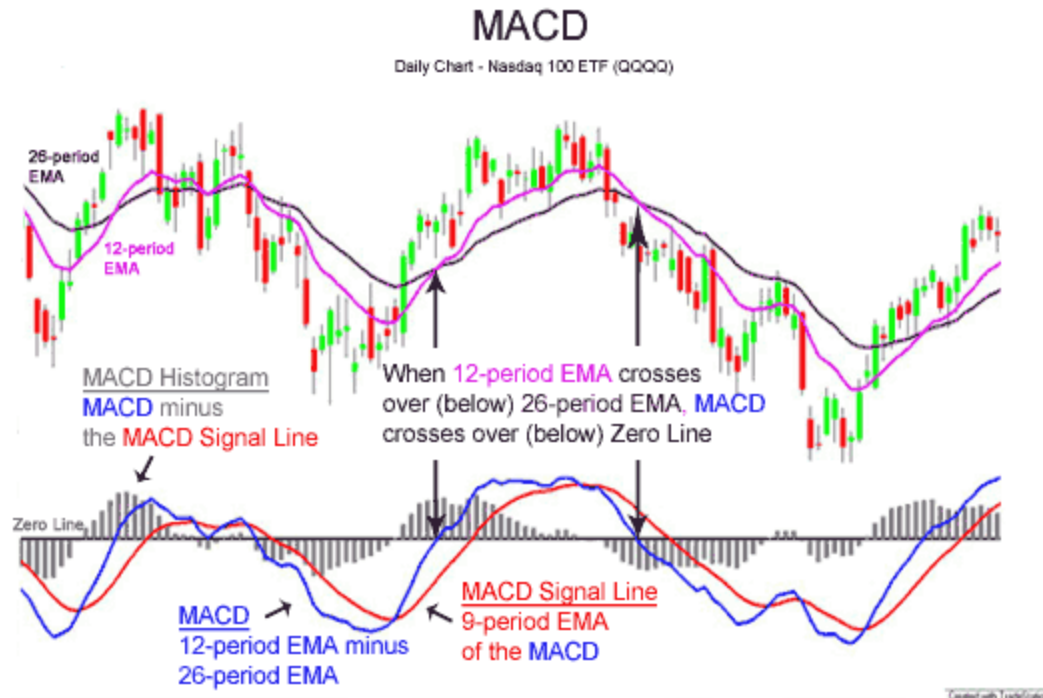
**MACD-** “which stands for Moving Average Convergence / Divergence, is a [technical analysis indicator](#) created by Gerald Appel in the late 1970s.<sup>[1]</sup>

MACD shows the difference between a fast and slow [exponential moving average](#) (EMA) of closing prices.

The example graph above right shows all three of these together. The upper graph is the prices. The lower graph has the MACD line in blue. The signal line, which is another EMA of the MACD line itself, is in red. The difference between the MACD line and its signal line is plotted histogram style along with the two MACD lines.

The set of periods for the averages can be varied. Appel and others have experimented with different combinations. The usual set of parameters is written as 12,26,9 for the fast EMA, slow EMA and signal line periods respectively.”





<http://en.wikipedia.org/wiki/MACD>.

## Stochastics

“In [technical analysis](#) of [securities](#) trading, the **stochastics oscillator** is a [momentum](#) indicator that uses [support and resistance](#) levels. [Dr. George Lane](#) promoted this indicator in the 1950s. The term *stochastic* refers to the location of a current price in relation to its price range over a period of time.<sup>[1]</sup> This method attempts to predict price turning points by comparing the closing price of a security to its price range.

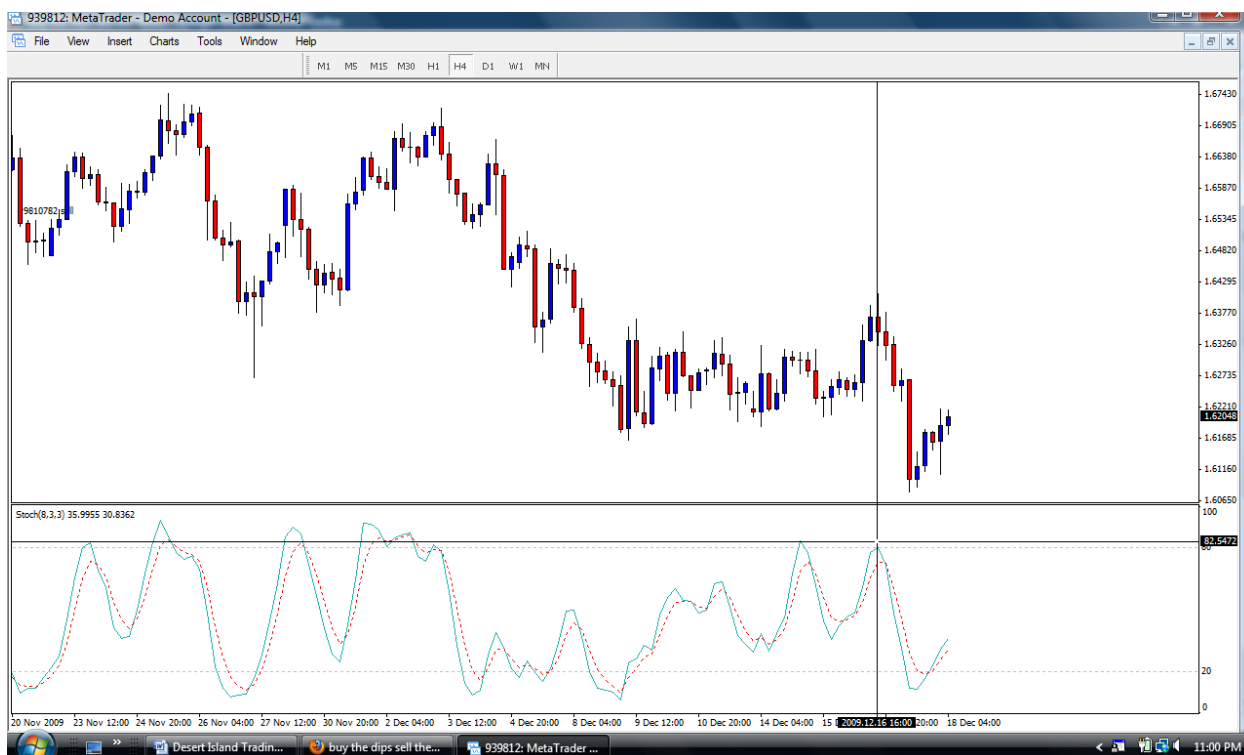
The indicator is usually calculated as:

$$\%K = 100 \frac{\text{closing price} - \text{price low}}{\text{price high} - \text{price low}}$$

Stochastics can be manipulated by changing the period considered for highs and lows. In working with %D it is important to remember that there is only ONE valid signal. That signal is a **divergence between %D and the security** with which you are working. “



- Stochastics in the overbought zone means the upside potential is limited.
- Buy the dips if the trend is up; sell the rallies in a downtrend.
- Buy when there is a complete retracement and a bullish reversal in an uptrend, and the opposite for a downtrend. For a downtrend the following example illustrates an oversold stochastics and a bearish reversal:



This chart shows the 4-hour time frame for the GBP/USD. The cross hair shows an oversold stochastics at 16:00 on 12/16/09. The reversal of the stochastics oscillator here is known as a bearish reversal. Following this signal, you can see the market continued down for almost a full day. Note that this downward movement does not always happen the way the chart demonstrates. Several factors must be considered, but this is the general rule for oversold stochastics and bearish reversals. The same applies for bullish reversals and oversold stochastics.

**-Basic fundamental principle to keep in mind: buy low and sell high.**

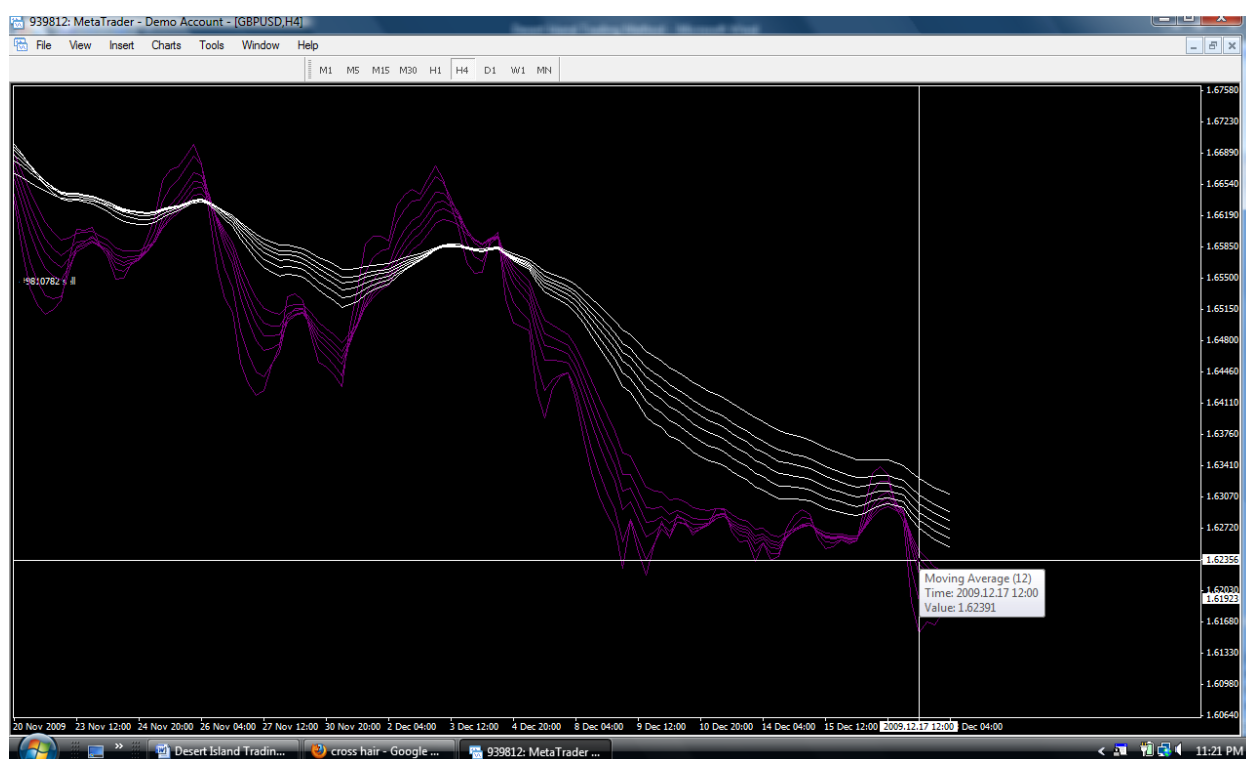
## Moving Averages

The following is a definition and description of moving averages

<http://www.investopedia.com/university/movingaverage/>: “Moving averages come in various forms, but their underlying purpose remains the same: to help technical traders track the trends of

financial assets by *smoothing* out the day-to-day price fluctuations, or [noise](#). By identifying trends, moving averages allow traders to make those trends work in their favor and increase the number of winning trades. We hope that by the end of this tutorial you will have a clear understanding of why moving averages are important, how they are calculated and how you can incorporate them into your [trading strategies](#). “

Moving averages work well when the market is trending, and these will be discussed in detail later. Conversely, when the market is sideways or choppy moving averages are not effective. The following chart illustrates two sets of moving averages:



This chart illustrates an ideal time to enter a short trade. Two sets of multiple moving averages are used here. The purple MMA group uses a 3, 5, 8, 10, 12 & 15 exponential moving average. This group represents the activity of short term traders. The white MMA group uses a 30, 35, 40, 45, 50 & 60 exponential moving average. This group represents the activity of investors or long term traders. This entry signal is for a

short (bear) trade, as the short term averages compress and then fan out or bounce off the long term averages downward.

Note that short term lines are ideally under the long term averages for a conservative entry. The long term averages are also ideally stretching out downward, above the short term lines. Exponential moving averages work better for most cases. Overall, moving averages are good to use as a trend following technique. These MMA's can also be used as a trading signal. The effectiveness of the MMA's is better when used in combination with other things. Finally, the exit signal for MMA's is when the short term averages lines compress and cross.