Exit Strategies & Stop Loss Techniques

Forex exit strategies are a very important part of Forex trading systems. In fact, it could be said, that out of all the components of a trading system, it is the exit strategy and the money management rules that are the most important to make a system profitable.

Let's firstly get an overall picture of the strategies that form part of Forex trading.

There are three parts to a trade:

There is the entry phase, the exit phase and the management of the exit phase.

We will deal now with Exit strategies:

The important thing to understand is that there is a vast difference between the exit strategies of Forex and Equity trading.

In equity trading you can wait for a cyclical or technical sell signal. The signal will usually be given 3 to 5% below the top or low point of the equity you are trading depending on whether you had gone long or short.

If you wait for a conventional sell signal in Forex trading the signal may be given late cutting down on the profit.

In a nutshell exiting a Forex trade successfully depends on setting targets incorporating stop loss levels and the money management of the trade.

Setting targets involves the use of support and resistance trend lines. The trade is exited when the trend lines are reached.

The TrueOBOS indicator also plays a very important role in setting a target for an exit level.

When the red overbought or green oversold levels are reached in the short term periods e.g. 15 and 10 minute periods these can act as an exit level.

Cycle peaks and lows are useful in confirming exit points as well.

All these indicators can be used in combinations. For example in trading long a cycle peak occurring at the same time as a resistance level is reached by the price will reinforce the decision to exit the trade. If this takes place at the same time as the overbought red line is reached this would be added confirmation that the trade should be exited.

The same applies to a short trade when a cycle low occurs at the same point as a support line is approached by the price. The trade would be exited. Added confirmation is given if the oversold TrueOBOS green line is breached.
There are 3 basic methods for exiting a trade, the professional approach to exiting a trade, the Cycle Trends method and the defensive method of using stop losses.

Joz Britz will show his practical method.

Here now is a description of the three methods that are used to exit out of a trade and take profits.

The professional approach:

The principle is to cash in the bulk of the trade and leave a smaller amount to ride a potentially bigger move.

Different traders favour different split percentages:

One split would be to take 80% off the table and leave 20% to ride the market.

Another split would be 60% off the table and 40% to carry on.

I know a trader who works on a fifty fifty split.

The split can vary according to the risk profile of the trader.

You automatically close 50% to 80% of your trade when there is a profit of between 10 and 20 pips or when a very short term target has been reached or when one of the fast Trendic indicators e.g Trendic 55 has turned in the opposite direction to your trade.

The amount of pips will depend on the strength of the technical position of the trade. You then allow the remaining contract to run until there is a definite technical indication that the trend of the trade has reversed.

Example of split taking 80% off the table and leaving 20% to ride the market.

If we were trading 10 contracts, we would cash in 8 contracts and leave 2 contracts open to carry on with the trade.

We are trading 10 contracts at $10 per pip for each contract. This means that each pip movement would equate to $100 per pip.

So if we were looking at making 10 pips profit using this exit strategy, we would close 8 of our contracts at our 10 pip profit and would make $800. We would then leave 2 contracts open to ride the market.

Remember: when using this method, you need to adjust your stop loss on the 2 contracts to a point so that if the market turns against you the profit that you have taken will not be wiped out. A trailing stop would be put in. (This is dealt with further on)

This way you have already banked 80% of your profit and you are not risking losing all the profit you have just banked on the contracts that remain open.
So if the market goes against you after you have cashed in your 8 contracts ($800) at most you would only lose the 2 contracts ($200).

In actual fact you only start making a profit once the spread of the trade, which may be 3 pips has been covered.

So the question is - When do you cash in the first part (50% to 80%) of your trade?

This can be done in three ways:

1. You can decide to automatically take a profit of x number of pips as soon as the price reaches this target regardless of the technical position of the trade.

   or

2. Close the trade in stages. 10 pips profit is taken and banked when the price has moved by that amount and a further profit is taken when the price has moved by another 10 pips. The remaining percentage of the trade is allowed to run till there are signals from the cycle indicators that the prevailing trend has changed.

   or

3. Cash in the major portion of your trade at a short term target or cycle peak. As Cycle Trends cycle indicators allied to the trendlines can give these very short term targets and sell signals this is the preferred way to exiting from a trade. This combines the professional technique with the Cycle Trends indicators

This 15 minute graph of the EuroUSD illustrates the technique:
Analysis

The graph is divided into 3 boxes, the **line graph** of the EuroUSD in Box 1, the **Cycles Array** in Box 2 and the **TrueOBOS** indicator in Box 3.

Now the trader has purchased and **gone long** on the EuroUSD at point “A” in Box 1.

*The reason?* The EuroUSD has hit a cycle low at the same level of “A” in Box 2 and is at the green oversold line in Box 3. At the same time point “A” in Box 1 is on support. The level of the purchase is round 1.385

Where would the trader cash in and take his the first profit?

He would look for the first **resistance trend line** drawing it from a previous trading level.

This line is clearly seen in Box 1.

So he would take his first profit at point “C” cashing in anything from 50% to 80% of his trade.

OR

The trader may decide that he would wait for one of the cycle indicators to signal a decision to cash in his profit.

TrueOBOS is one of the best indicators to give such a signal. Taking a profit at the **overbought red line** is always indicated. This is point “D” in Box 3. This is confirmed by the Array cycle peaking at point “D” in Box 2.

The alternative strategy would have been to cash in profits both at point “C” and “D” if the trader had a strategy to cash in the major part of his trade in 2 parts. Here is an example when going short:
In this 15 minute candles Hi Lo graph of the GBP/USD the trader went short at 1.53.

Setting his target at the parallel support trend line at 1.511 the trader would wait till this line was reached.

The oversold TrueOBOS level was approached at the same time as the price reached the support line.

Further confirmation was given by the “Array Bartels Trade” cycle turning north in the future zone though the Trendic 55 had not turned positive.

The trader would cover his short at 1.511 taking a substantial profit.

**The Stop Loss Method**

Exit strategies based on using the stop loss method is a defensive strategy to prevent losses and preserve profits.

We call it placing or putting on a stop. Traders use the Stop Loss technique to limit potential losses.

In text books there are 4 recommended types of stops: initial, trailing, take profit stops, and stops due to fundamental events in the market such as announcements.

We employ 2 methods initially to limit your losses.

**The Initial Stop:**

Firstly when we enter a trade we automatically enter a pre-determined stop loss.

The purpose of the initial stop is to get you out of the trade early on and so limit your losses at the start.

The decision is unemotional and is therefore not affected by hopes that the market will turn around. To win you should take the emotion out of trading.

The second method is to put in protective trailing stops using your Cycle Trends program.

This involves using the Trend Line techniques of support and resistance that you have in your Cycle Trends program.

A: We will deal with the automatic placing of stops first.

Again there are two methods here:

1. Simply place your stop loss 20 to 30 pips below the entry level if you have gone long and 20 to 30 pips above the entry level if you have gone short.
2. You can use the trend line resistance and support lines on the chart to set your stop loss levels.

If you have entered a long trade based on the bounce from a support trend line, allied to a cycle low, the stop loss is placed 5 to 10 pips below the support line. Obviously this is done in case the currency goes into reverse after the bounce from the line.
This is illustrated in the next graph featuring the EuroUSD.

If you have gone short based on the downward bounce from a resistance line, allied to a cycle peak the stop loss would be placed 5 to 10 pips above the resistance line.

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**Analysis of EuroUSD 60 minute graph showing Initial Stop and Trailing Stop:**

Note the “Support trend line” and the rising “Array Bartels All” cycle on the graph.

Assuming you had gone long on the EuroUSD at the “Buy” point on the graph.

You would place your initial stop at Point “X” 10 TO 20 pips below the support line.

Following the lead of the “Bartels All Cycle” the EuroUSD would have penetrated through the strong Resistance Trend Line seen on the graph.

A **Trailing Stop** is placed 5 to 10 pips below the resistance Trend Line at point “Y” on the graph.

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**The Trailing Stop**

The **trailing stop** is used when your trade starts moving into profit. The purpose is to **protect the profit that is already there**.

The Trailing Stop is featured in the previous graph.

The Trailing Stop, as a part of your Forex exit strategy, is a stop that moves in the direction of the trade, which is up for a long trade and down for a short trade. An ideal stop is one that allows enough "room to move" and hence allows the profits to run, and eventually gets you out when the trade does turn against you.
The trader doesn’t want to see the trade reverse from a strong profit situation back into a loss situation.

The best way to do this is to place your stops at support and resistance lines that have been penetrated by the price as it moves into profit.

A Trailing Stop is placed 5 to 10 pips below the resistance Trend Line when going long and above the support line when going short.

**Take Profit Stop**

When placing an order on the trading station you can also set a target profit of “x” number of pips. The profit will automatically be put into your account when this level is reached.

This is useful if you are following the management rule of cashing in the majority of your capital initially and then allowing the remaining portion to carry on. You exit when a target profit of “x” number of pips has been reached.

On the FXCM Trading Station this stop is known as a Limit order. You put in your order in a Limit Box which is adjacent to the Stop Box.

Finally, a trade may be exited before a major economic announcement due to an expected large increase in volatility. This is done at your discretion.