TRADER ON THE STREET

BUCKING THE TREND

FADING YOUR TRADES IN AN OVEREXTENDED MARKET

While trading is inherently risky, there are some strategies that even though they might elevate that risk, are still highly profitable. One such strategy is fading. And if you enjoy shorter-term trading, fading is an approach suited for that particular psychology. You can try your hand at fading in overextended markets if you believe sentiment is incapable of moving in the same direction for longer than it already is. How to fade overextensions takes time and practice, and being able to read price charts is key to making it happen.

WHAT'S FADING?

In the currency trading world, fading is described as placing trades against the trend. So, the traders trust that the markets will turn the other direction and hit their profit targets. To simplify it, traders who fade buy when the market is falling and sell when it's bullish. While this goes conventional market wisdom, fading is more about being patient and paying attention to real-world data to make decisions.

WHAT ARE OVEREXTENSIONS?

Overextended markets are when price action has been in a trending range for a long period of time, with no significant pullbacks. When this occurs, most traders tend to continue trading along that trending range, with little to no preparation when it starts to reverse.

HOW CAN I FADE OVEREXTENSIONS?

Firstly, it helps to examine charts on a medium to high time frame. Shorter-term fluctuations often won't give you enough data to make an educated choice. Once you have identified an overextended market, it's crucial to place support and resistance levels based upon where you believe it might break. Then, pinpoint entry lines based on small pops in price action that break the current trend.

Learning to fade also comes with understanding how other traders might react to these kinds of markets. If all traders follow the same adage of "buy high, sell low," then it's often wiser to fade the overextensions than to trade with the trend.

With overextensions, as pullbacks become more scarce, opportunities will always arise to set up your trades. Because big trending ranges in trading are often too good to last. So, it helps to identify overextended conditions so you're not decreasing your risk to reward ratio.