Kevin Pyne's "Stay Friends" Trend Strategy

Introduction

"The trend is your friend" is likely the most commonly known- and understood- cliché in the investing and trading world. Probably because it is true! However, "all good things come to an end" is another idiom which Ed Seykota was thinking of when he said, "The trend is your friend, until it ends when it bends." So, there will be a time that a friendly trend will turn and reverse. Will it be your friend then? Well, here is a foundation set-up that can help you stay friends with trend by identifying ideal entries to continue with a longer-term trend and, also find possible trend reversals coming up in the markets.

The Trend Is Still Your Friend

The old cliché really is true and should be followed. In this strategy, it is important to identify the overall trend on a weekly or daily basis and locate areas of support and resistance. Remember that an uptrend is defined as a series of higher highs and lows, a downtrend defined as a series of lower highs and lows. Once you identify the trend on the longer-term chart, it helps to stay with that as much as possible. The trend is, and always will be, your friend. But why is that? Trading with the overall trend is trading with the overall crowd. It increases your probabilities of success. In trading, you need every edge you can get.

Short-term Within Long-term Trends

Remember that trends are made up of a combination of short-term, intermediate-term and long-term trends. This means that the current trend could have a short-term downtrend within a long-term uptrend, or a short-term uptrend within a long term down trend. For the purposes of this set-up, it is important to recognize this concept because we can identify possible short-term trend changes within a long-term trend and ultimately, stay friends with the trend.

What we can do to identify a potential trade is use a couple of indicators to help us see the condition a market is in. The ADX indicator or Average Directional Index is used by traders to determine the strength or integrity of a trend, whether it be up or down. The common indicator normally has three lines, the average directional line, the minus direction and the plus direction. For the purposes of this set-up, the average directional line showing the trend strength is the only one needed. The higher the number on the ADX line, the stronger the trend.

By itself, the ADX is a powerful tool. Coupled with another tool, say the Stochastic, makes it even more so. It can give us the conditions for which we are looking for: the change of a short-term trend or the continuation of the long-term trend. Let's now take a look at the rules for the conditional set-up.

Chart Indicator Set-up

- ADX (10), turn off or whiteout the Plus-Di and the Minus-Di
- Stochastic (14,3,3), change the default for K-period from 5 to 14

Steps for Bullish Condition

Figure 1 – EUR/JPY Daily

1. Start with a Daily Chart
2. Look for ADX to be above the level of 40, showing a strong trend. Then look for it to turn downwards, to indicate the trend strength weakening.
3. Stochastic to be below 20, showing an oversold market. Then look for it to turn upwards, indicating a change in momentum.
4. Look for an area of support, an area where the market pivoted in the past.

Figure 2 – EUR/JPY 4 Hour

5. For more confirmation, and better timing, change the time frame to a 4 hour chart
6. ADX level to be above 35-40 on the 4 hour chart and starting to turn down
7. Stochastic below 20 and starting to turn up
8. Placing multiple potential targets (scaling out technique) at previous resistance areas

Steps for a Bearish Condition

Figure 3 – AUD/CAD Daily

1. Set up a Daily Chart
2. Look for ADX to be above the level of 40, showing a strong trend. Then look for it to turn downwards, to indicate the trend strength weakening. (Note: In this example with the AUD/CAD in Figure 3, the ADX line measured higher than 72 before it started to turn, which happens very rarely. On average, the indicator peaks in the 40s and 50s, sometimes the 60s. It is important to wait for the indicator to turn downwards.)
3. Stochastic is above 80, which shows the market in an overbought condition. Wait for it to turn, preferably below 80, in order to show a change in momentum. (Note: Notice that the Stochastic indicator stayed in the overbought area for several days before ADX started to turn down. This is the advantage of using these indicators together.)
4. Look for an area of resistance, an area where the market pivoted back down in the past.

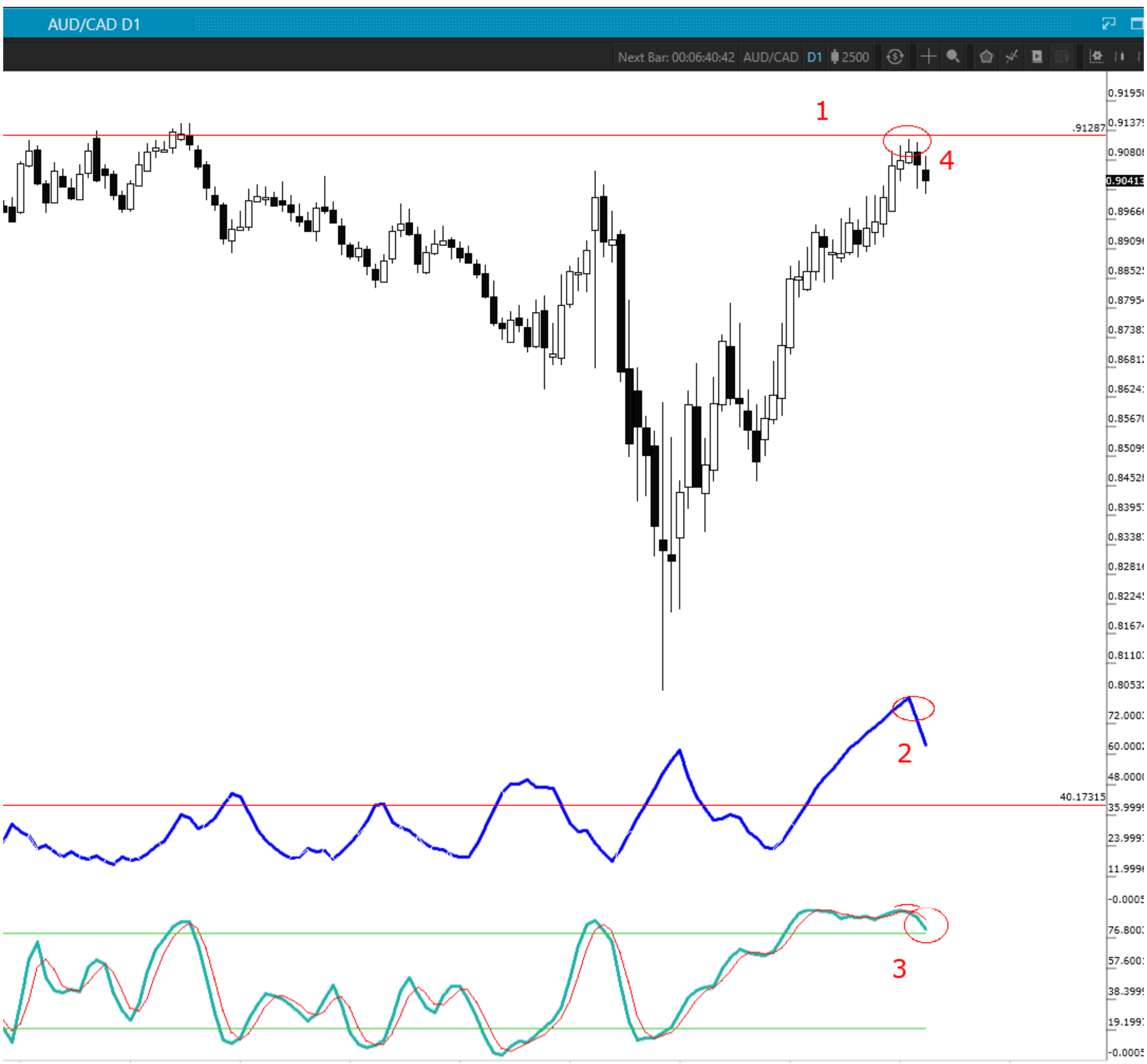
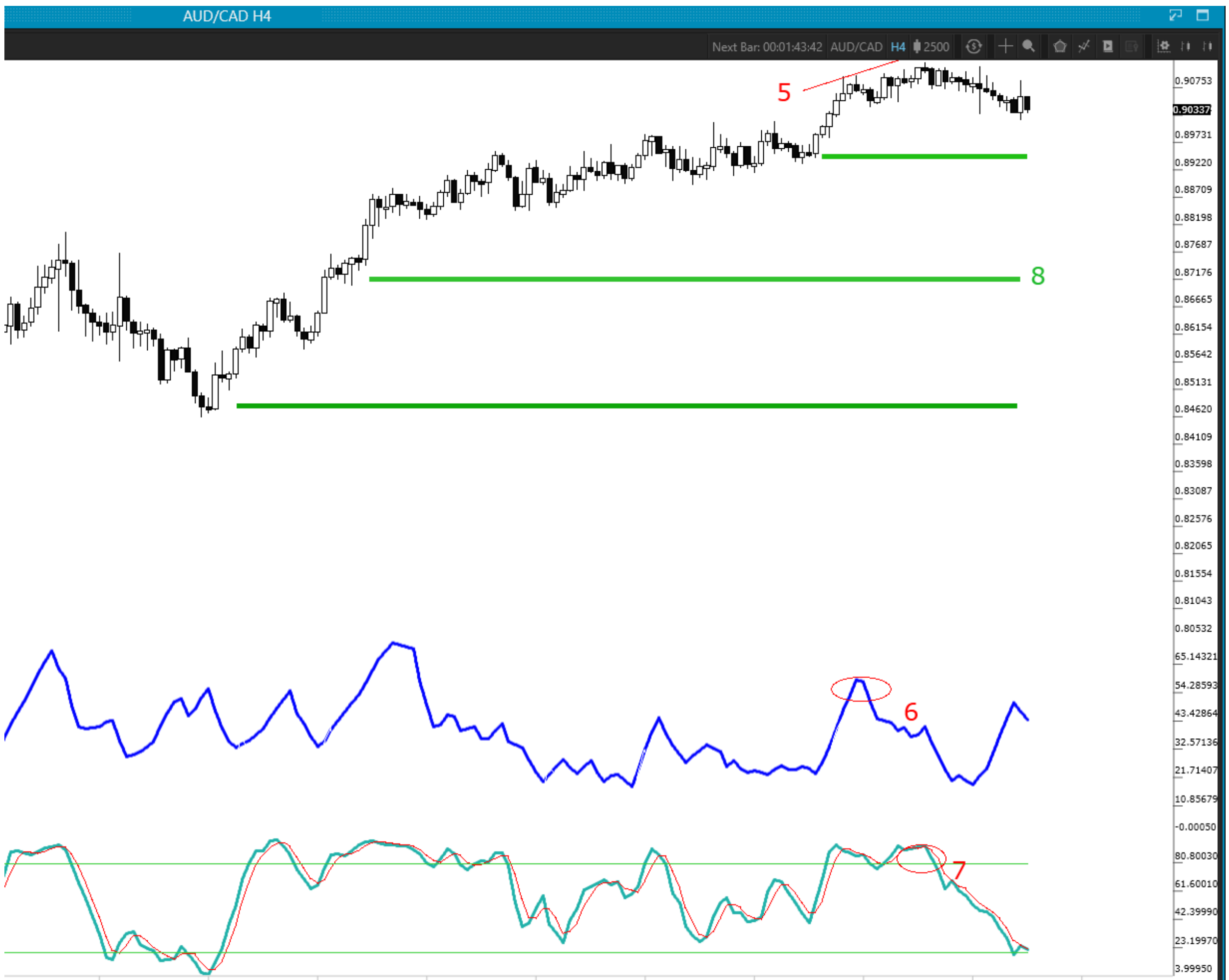


Figure 4 – AUD/CAD 4 hour

5. For more confirmation, and better timing, change the time frame to a 4 Hour chart
6. ADX above the 35-40 level on the 4 Hour and starting to turn down
7. Stochastic above 80 and starting to turn down
8. Placing multiple potential targets (scaling out technique) at previous support levels.



"Stay Friends" Tips & Notes:

- Remember, this set-up is more of condition in the market than it is stand alone strategy. It is a foundation upon which traders can build with other indicators or criteria to help them make entry decisions. In other words, after this condition is found the entries and exits are subjective. It is a swing/trend strategy so expect to be in a trade from one day to about two weeks.
- No indicator is perfect in its signals. There will be times this condition occurs but the trend does not take its expected turn. Be sure to incorporate proper risk and trade management into your overall strategy.

- Risk Management is a key component of a profitable trading strategy; this one is no different. Stops should be set above and below major pivots to reduce the probability of being stopped out. Risk:Reward should be at least 1:1 ratio. For example, if the first take profit target is at 50 pips, the stop can be set at 50 pips. If the take profit is at 35 pips or 75 pips, then the stops should be placed at 35 and 75 pips respectively.
- Money Management: Breaking down your lot size into smaller lots and multiple trades will help you manage a few things while in the trade. Scaling in will help you get better prices, scaling out will potentially help you let winners run and make more than you would with your risk allocated to just one trade. So, place your take profits at a higher target, to allow the market to work in your favor, potentially improving your risk:reward ratio!
- More risk management: When the first target is executed and profit is booked into the account, the other trades should be moved to break-even. This allows the rest of the position to stay with the new trend and potentially make more profit with no more risk to the account.