

Super Trading Strategies

Tapping the Hidden Treasure in the Markets

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SAMPLE

A Parabolic SAR Trading Method

Trading the Short Term Trending Movements

There are many ways to make money in the markets. We are talking about speculators who have a huge edge because of their knowledge and risk control methods. One of the ways to make money is explained here. It has to do with one great, but often underestimated indicator called Parabolic SAR. The indicator is very helpful when it is used properly in the markets. How can we use the Parabolic SAR properly and thus get rewarded financially? This chapter answers the question.

The Behaviour of the Parabolic SAR

The Parabolic SAR is useful in knowing where to put stop-loss and where to trail the stop when the market moves in our direction. When the indicator appears below the price, it generates a long signal (reverse the rationale for when it appears above the price). When the Parabolic SAR appears in the opposite direction, then an exit is generated. Since the indicator follows a dominant bias, we can say it is a trend-following indicator. When a trending movement begins, the indicator follows it (acting like a trailing stop). This means that when the trading instrument goes upwards, the Parabolic SAR which acts as a stop rises logically with it as long as the bias is upwards. When the trading instrument goes downwards, the Parabolic SAR which acts as a stop goes down logically with it as long as the bias is downwards.

In the wake of an uptrend, the Parabolic SAR continues to rise in a bullish market and thus guards our gains as the bullish market continues. When we follow this analytical tool, we can see the reason why it would not be in our best interest to widen our stop. When the trend reverses drastically and crosses the Parabolic SAR downwards, that means the bias has gone bearish and thus, the indicator shows above the price. As the market backtracks, the indicator begins to act as a trailing stop for the bearish market – as long as the bearish market holds out. Since the Parabolic SAR does not go up in a bearish market, it guards our profits in the market. The same is true of a bullish market; the indicator does not go down in a bullish market, and thus it protects our profits, ensuring that we get out only when there is a considerable change in the bias. This feature is useful for those who use the indicator as a trailing stop. In this chapter, the Parabolic SAR is used mainly in the entry criteria.

Combining the Parabolic SAR with the ADX Period 14

The Parabolic SAR works great in a trending move, so we may consider putting it aside when the market is not trending. Otherwise, the accuracy of the signals generated by the indicator may be reduced considerably in flat markets. It is irrational to use the indicator in a trendless market. Those who fail to resist the irrational urge pay a heavy price. That being said, a trendless market is a trap for Parabolic SAR users. Only time will tell whether it is the trap or the squirrel that will survive on the farm. How do we know that the market is flat (trendless)? We know this simply by looking at the chart and seeing that the price is generally moving sideways. How do we know that the market is trending? We know this simply by looking at the chart, and seeing that the price is going upwards or going downwards. Moreover, the Average Directional Movement Index (ADX) period 14 can also help us to know when the bears dominate the market or when the bulls dominate. This happens when the ADX +DI crosses above the -DI; or vice versa. +DI signifies bullish pressure and -DI signifies bearish pressure. Combining this with the Parabolic SAR improves the trading accuracy in a trending market.

You can see the Strategy Snapshot for entry criteria for short and long trades. When a trading signal is being taken, we want to be sure that the Parabolic SAR on the hourly chart and 15-minute chart are saying the same thing. Do not enter a trade against the 15-minute parabolic SAR.

Some Recent Trades

The colour for the Parabolic SAR, which appears as dots in the chart, has been changed to blue. The ADX period 14 line has been changed to green. The +DI is blue while the -DI is red. The ADX level 30 is chosen (black). A bias is particularly strong when the ADX line goes above the level 30. Please note that these are not the default colours: The ones used are the ones the author preferred. In the examples below, the red vertical line on the left shows where a trade was entered, and the red vertical line on the right shows where it was smoothed, especially in the hourly charts. We do not consider spreads here.

Example 1:

On 26 August 2014, the EUR/CAD, which was already bearish in outlook, continued its weakness. In Figure 1, you can see the Parabolic SAR and the ADX period 14 in the hourly chart. A sell signal was generated as the Parabolic SAR appeared above the price, and soon after, the signal was confirmed by the ADX as the -DI crossed the +DI to the upside. Seeing this, the 15-minute chart of the same trading instrument was checked and it was seen that the Parabolic SAR in that chart was also giving the same sell signal (at the same time and the same hour as the hourly chart). The trade was taken immediately. The only thing that mattered was the position of the Parabolic SAR in the 15-minute chart, confirming the signal that was seen in the hourly chart. After this, what happened to the Parabolic SAR – whether it appeared next above or below the price – was of no significance. It was a high probability setup, which turned out to be a winning trade. This kind of trading approach enables low-risk entries plus optimal stops.

F1) A Sell Signal on the EUR/CAD



The Parabolic SAR and the ADX period 14 in the hourly chart.

Instrument: EUR/CAD

Order: Sell

Entry date: 26 August 2014

Entry price: 1.4465

Stop-loss: 1.4505

Take profit: 1.4360

Exit date: 27 August 2014

Status: Closed

Profit/loss: 80 pips

| Strategy Snapshot | |
|------------------------|---|
| Strategy Name: | Parabolic SAR Trading Method |
| Strategy Type: | Trend-following |
| Suitability: | Good for intraday and swing traders |
| Time Horizon 1: | Hourly charts |
| Time Horizon 2: | 15-minute chart (for confirming entry signals) |
| Indicator 1: | Parabolic SAR (default parameters) |
| Indicator 2: | Average Directional Movement Index (ADX) period 14 |
| Short Entry: | Go short when the Parabolic SAR appears above the price and the ADX 14 has its +DI below the -DI. At this time, the SAR in the 15-minute chart must also be above the price |
| Long Entry: | Go long when the Parabolic SAR appears below the price and the ADX 14 has its -DI below the +DI. At this time, the SAR in the 15-minute chart must also be below the price |
| Exit: | A trade is closed only when the stop or the target is hit. It is also closed if it is still open after 48 hours |
| Filter 1: | Stop trading for the week when your loss exceeds 3.5%. But so long as you do not lose 3.5%, you may want to trade continuously |

| | |
|--------------------------------|--|
| Filter 2: | Do not trade a sideways market. Only trade a trending market |
| Filter 3: | Do not trade against the 15-minute Parabolic SAR. Take a trade only when it agrees with the 15-minute Parabolic SAR |
| Position Size: | Use 0.01 lots for each \$2000 (and thus making it 0.05 lots for \$10,000); or 0.1 lots for each 20,000 cents in a cent account (making it 0.5 lots for each 100,000 cents) |
| Stop: | 40 pips |
| Take Profit: | 80 pips |
| Trailing Stop: | Trailing stop is optional – it may be used according to the movement of Parabolic SAR |
| Maximum Trade Duration: | Close an open trade that is more than 48 hours old |



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