# Understanding the Trading Cycles in Forex Market

## Trend Is Your Friend

Forex trading systems are what we often call "**reactive systems**". There are many factors at work, and they cannot be quantified and measured to enable decision making. Forex traders, therefore, trade the trend. In other words, they try to time the market.

**Most successful Forex traders believe that the markets have a cycle**. This cycle is the result of human behaviour in the markets. As a result of this innate human behaviour, trends seem to repeat in the market. If a trader can chart these trends and predict future movements, a fortune can be made! The critical part here is recognizing the different stages in the market and which stage you currently lie in.

In this article, we will understand how a trader can recognize the four different stages in the trading cycle. We will also have a look at how a trader can then use this information to make profitable trades.

## Equilibrium: Moving Average

Trading is all about understanding what equilibrium is. Equilibrium is the correct market price at which the stock should ideally sell. If the market price is below equilibrium, then the trader should go long. If the market price is above the equilibrium, then the trader must consider the currency pair to be overpriced. Forex market traders define equilibrium as the moving average of the past prices. Moving averages are calculated for different durations. They could be calculated for 50 days or 200 days or so on. Depending upon how long term or short term a trader wants to trade, he/she can use the moving average to figure out the equilibrium price.

## Stage 1: Range Bound

In the absence of any trend in the market, currency pairs tend to be range bound. They fluctuate between predictable daily highs and lows. The Bulls try to raise the price, but they immediately meet with resistance from the bears. If the price moves downwards beyond a given range, once again the forces of equilibrium raise the prices back to the equilibrium. In such scenarios, traders should make multiple short-term trades. They should sell after the movement of just a few pips because in case they do not, the prices will fall back.

Range bound movements typically end in a breakout which is the second stage of this cycle. The longer time the range bound movements persist, the bigger is the breakout. Also, some market participants may try to create a fake appearance of a breakout. Forex traders can avoid being duped by these market manipulators by checking the volume of trading that is happening to ascertain if the price discovery process is functioning as intended.

## Stage 2: Breakout

Stage two is the breakout stage. This is the stage where the market breaks its inertia meaning that range bound movements are converted into clear upward or downward trends at this stage. The breakout stage can take a couple of forms depending upon the velocity of the underlying currency pair.

**Straight Up:** The movement could lead straight up in case there has been some drastic change in the underlying currency. This happens rather quickly and then the price plateaus. Traders should either jump into the trade early or they should not jump into it at all. Entering this trade later could mean facing a flat price or a downside.

**Higher Peaks and Valleys:** The movement may not be so one-sided if the breakout is not caused by a clearly identifiable change in fundamentals. In this case, the market will face resistance as it moves up. At each point, it will reach a higher price. Also, each trough will also be higher than the previous one. Hence, the price may fall in relation to intermediate points but will only rise as compared to the original price.

It is important to note that during this stage, the moving average price rises. Hence, the trend analysis within itself carries the seeds of a return to equilibrium.

## Stage 3: Decline

As the name suggests, stage 3 is when the prices peak out and start returning to earlier levels. This stage can also have different scenarios based on the momentum of the markets.

**Nosedive:** Once again if the fundamentals of the currency pair have changed, the market will react very quickly. The prices will be down by several percentage points in an instant. Short positions should either be taken very quickly or not taken at all.

**Falling Peaks and Troughs:** Price could fall in a series of peak-trough movements. This means that the price will not fall in a straight line but will face resistance at each level.

In this stage, the moving average falls and hence this stage carries in itself the possibility of a rebound.

## Stage 4: Uncertainty

After a bull and bear run has been completed, the market faces uncertainty. The cycle has to start all over again. However, few people are able to guess the future course of action correctly. This stage is characterized by marked volatility. Since any kind of prediction is so difficult even with the help of technical indicators, investors are generally advised to stay away from the market during this stage.