Chapter 2.1

Charting Basics

CHARTING BASICS

Charts are a forex trader's best friend. As a Forex trader, you will most likely utilize your price charts more than any other available tool. Since your charts are going to play such a large part in your trading, it is imperative you become familiar with them. The more comfortable you are with your charts, the easier it will be to become a successful forex trader.

To help you become acquainted with your charts and how you can effectively use them, we will cover the following concepts:

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CHART SETUP

Let’s start from the very beginning and take a look at how a forex price chart is set up. Once you understand the basics, you will be much more successful applying more advanced concepts to your technical analysis.

Forex price charts are built on two axes—the X axis (horizontal axis) and the Y axis (vertical axis).

The X axis runs horizontally along the bottom of the chart providing a timeline for everything that has happened on the chart. The most recent price action is shown on the right side of the chart and the most distant price action is shown on the left side of the chart.

The Y axis runs vertically along the right side of the chart providing a price scale for the price movement on the chart. Lower prices are shown toward the bottom of the chart and higher prices are shown toward the top of the chart.

When you put the two axes together, you can see at what price a currency pair was trading at a particular time in the past. For example, you can see that the EUR/USD was trading at 1.4000 on 20 September 2007.

CHART TIME FRAMES

#ÏôÎ îô4òÁÄÅô forex charts give you the ability to analyze the price movement of your favorite currency pair anywhere from a minute-by-minute basis to a month-by-month basis. You have the flexibility to choose which time frame is best for you.

If you are a shorter-term trader, you will want to use shorter time frames for your charts. If you are a longer-term trader, you will want to use longer time frames for your charts. For example, a trader who is looking to quickly jump in and out of trades for 10- to 20-pip profits would most likely want to be watching a 1-minute or a 5-minute chart. A trader who is looking to hold onto trades for a longer period of time to take advantage of larger price moves would most likely want to be watching an hourly or a daily chart.

Some traders even choose to use multiple time frames so they can see how the movement of a currency pair looks from various points of view. We will discuss this concept in detail in a later section.

To change the time frame on your chart to best match your trading style, click on the button at the top of the chart. A drop-down menu will appear, and you can select your preferred time frame.

CHART TYPES

#ÏôÎ îô4ôÁÄÅô forex charts give you the ability to analyze the price movement of your favorite currency pair in various formats, from line charts to candlestick charts. You have the flexibility to choose which format is best for you.

Technical analysis is a visual, almost artistic, skill that traders develop, and different traders like to practice their art on different types of charts. Some traders feel they can see and analyze support and resistance levels better on a line chart, while other traders feel they get more information on price movement on a bar chart or a candlestick chart.

Technical analysts tend to gravitate toward the following three chart types:

-	Line charts
-	Bar charts
-	Candlestick charts

LINE CHARTS

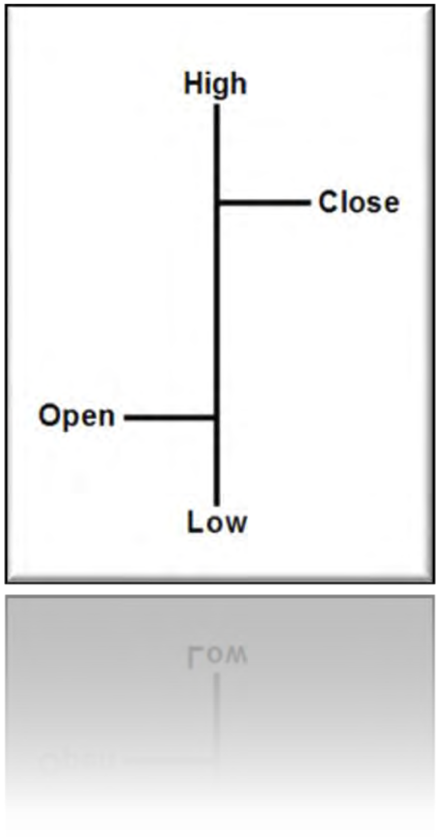
Line charts are the most basic type of chart. Technical analysts often use line charts to easily identify support and resistance levels. Line charts only have basic information plotted on the chart, which means there is not a lot of other "clutter" to get in the way of your analysis.

You create a line chart by plotting the closing price of each trading period on a chart and then connecting each closing price with a line. You can see an example of a line chart below.

BAR CHARTS

Bar charts provide more information than a line chart. Technical analysts often use bar charts to gain more information about how a currency pair's price moved up and down during each trading period. Whereas line charts only plot the closing price from each trading period, bar charts plot the opening, high, low and closing prices from each period.

You create a bar chart by plotting a series of bars across the chart. Each bar represents one trading period. To create a bar, you plot the high and low price of a trading period and connect them with a vertical line. Next, you plot the opening price out to the left side of the vertical line you have just drawn and connect that point to the vertical line with a horizontal line. Last, you plot the closing price out to the right side of the vertical line you have just drawn and connect that point to the vertical line with a horizontal line.



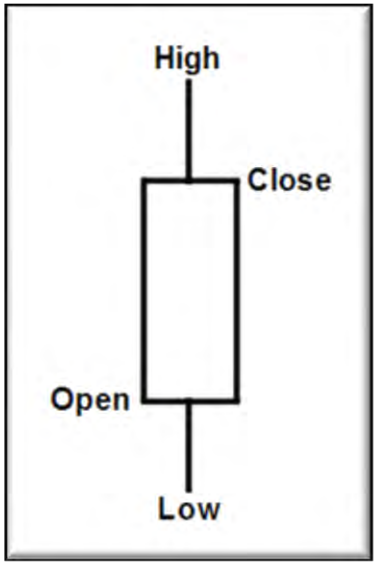
Seeing where a currency pair started the trading period compared to where it ended the trading period can help you better identify trends. If the price closes higher than it opened, you know investors were bullish on the currency pair during the trading period. If the price closes lower than it opened, you know investors were bearish on the currency pair during the trading period.

You can see an example of a bar chart to the right.

CANDLESTICK CHARTS

Candlestick charts provide the same information as bar charts but in a slightly different format. Technical analysts often use candlestick charts instead of bar charts because it is easier to see and identify various trading patterns using candlestick charts. In fact, a complete line of technical analysis—Japanese candlestick-chart analysis—was developed around these easy-to-use charts.

You create a candlestick chart by plotting a series of candlesticks across the chart. Each candlestick represents one trading period. To create a candlestick, you plot the high and low price of a trading period and connect them with a vertical line. This line is called the wick of the candle. Next, you plot the opening price by drawing a horizontal line through the vertical line, or wick. After you have plotted the opening price, you plot the closing price by drawing another horizontal line through the vertical line. Lastly, you fill in the area between the opening price and the closing price. This area is called the body of the candlestick.



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You can see an example of a candlestick chart to the right.

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