Swing Trading with Heiken Ashi and Stochastics

By: Hugh Briss

*Please note: The **Bold** emphasis are mine to help me understand better---elPips*

I started a thread a good while ago regarding a similar method of trading to this but the core system has evolved slightly as these things tend to and so I have decided to create a new home for people following this method.

The basic method is deceptively simple but profitable. **It uses very few indicators and is trend following in nature**. **I like to use 4 hour charts but other people are using other time frames successfully**. Also there is a healthy debate about the most profitable stop loss and target combination which will be forward tested live in the thread.

I have been posting trades a few hours before the 4 hour candle close that triggers them and I will continue to do so if possible. **Being a trend trading method there can be periods when no trades present themselves but it is usual to see 5 or more trades per week**. In back and forward testing this has proven to be profitable but a lot depends on your stop and target so I won't give exact strike rate figures here as I want to thoroughly test all the options first and then I will update this first post with the stats.

The Indicators:
Heiken Ashi candles
100 sma close
Stochs 8,3,3, low/high
HeikenAshiAlert.mq4 – (**Post#44**) f*rom HB...works fine but only signals once the candle has closed.*

The Heiken Ashi candles are "average price" candles. They are calculated using a moving average and change colour according to that average. The open, high, low and close of these candles represent slightly different things to normal candles and the best way to get a feel for them is to put them on your chart and see how they look. If you have metatrader you can go to a line chart and then set line chart to "none" in the chart properties and that gets rid of the line leaving you a nice blank screen to put your HA candles on. Notice how the candles can sometimes stay one colour for a long period of time, hundreds of pips on a 4 hour chart. Catching and holding on to these long trends can be very profitable but of course it is not always as easy as all that!

The 100 SMA is **there to help visualise the trend**. As a basic rule of thumb if the price is above the ma the trend is up and we only want to buy and below is down and we only want to sell.

The Stochastics (8,3,3) give us information about the strength of the pullback in the trend. I find stochastics to be the best momentum based oscillator to help visualise turns in the trend and they work very well with HA candles.

The Basic Method

I will be posting lots and lots of charts but as a general outline you want to see the moving average moving smoothly in one direction for a period of time with the price making the classic zig zag movement up or down the page. **In an uptrend you want to see a move up followed by a smooth decline in prices signified by green HA candles followed by red**. **When the HA candle turns back to green and the stochastics make a nice smooth cross towards the bottom of the stochs window then wait for the 4 hour candle to close and open your long trade**. In a downtrend you want to see the opposite. Like I say, lots of charts to follow.

Money Management, Stops and Targets

As mentioned above there is some debate over the best stop loss and target combination to use to capture the most profit from these signals.

There are 3 basic methods that I believe are worth testing.

1) Enter the trade with a 50 pip stop loss. Hold the trade open until the HA candles turn back against the trend moving the stop loss behind the trade as it moves.

2) Enter the trade with a 50 pip stop loss and a 50 pip take profit moving the stop loss to +1 pip after +25 pips is reached.

3) Enter the trade with a 50 pip stop loss and take half profit at +25 pips moving the remainder to break even at that point and trailing the stop loss as the trade progresses.

I'm sure there are other combinations that we can try and I will update this first post as we go along.

Charts to follow. Any questions please feel free to ask.

My favourite trading/financial books that I recommend...

The Richest man in Babylon - Author unknown
The Zurich Axioms - Max Gunther
Reminiscences of a stock operator - Edwin Lefevre
Forex Patterns and Probabilities - Ed Ponsi
Adventures of a currency trader - Rob Booker
Candlestick and pivot point trading triggers - John L Person

There are more that I can't remember right now but all of the above helped me in one way or another so I recommend reading them.

More comments from Hugh Briss:

Post#21

A little bit about systems, probability and expectations...

A very good reason why new traders fail to make any money, and indeed lose money, is the search for the so called holy grail, that elusive system that never loses and always wins. I used to do it myself all the time, try out a system and after 2 wins, 2 break evens and 3 losses I would determine that it was no good and go on to the next one. **Experienced traders of course know that if your system is expected to give you a 40% strike rate at 2:1 risk/reward that is sufficient to make money**. Also, given those figures, you can expect 4 wins out of 10 trades and maybe 2 or 3 break evens with the rest losses. This represents a solidly profitable system. What can't be known is over 100 trades what order the wins, break evens and losses will come. With a 40% strike rate it is not inconceivable that you will incur 5 or 6 or more losses in a row before you reach a winner. Of course it can and does happen the other way round and you experience a run of winners. So why when most people profess to know this will they only work a system for 10 to 20 trades before abandoning it if it doesn't perform?

It is my feeling that it is more or less impossible to predict with any degree of accuracy a sustained direction for any market. What a trading system does is increase the probability of your trade working out and making you money against a randomly placed trade. **A trading system is not a license to print money but merely a way of identifying patterns and/or situations which have a higher percentage chance of making you money than a random guess.**

What really makes the difference between traders that make money and those that don't is that **winning traders are willing to be wrong quickly and willing to be right for longer.** In other words, and taking into account the randomness of the markets we trade, if it really is that a trading system will have winners and losers and we can't know in which order they will come then **it is vital to accept and close the losing trades quickly** and unless you are working with a fixed take profit to take advantage of a high probability situation you should hold on to your winning trades until you have a solid reason to close them.

I hope this makes sense and helps someone?

Post#22

All about Heiken Ashi Dojis...

Heiken Ashi candles differ from normal candles in that the open, high, low and close represent different things. **In an uptrend the bottoms of the candles will be "flat bottoms" with no wicks and in a downtrend the tops will be flat**. The **wicks of these candles** are the same as normal candle wicks and they do r**epresent the extremes of price** during that time period but **in a strong trend it is usual not to see a wick at the upper or lower end of the candle** (depending on the direction of the trend).

The "open" level of the candle is always the midpoint of the previous candle, ie the high minus the low divided by 2. The close of the candle represents the position of the moving average that is being used to calculate the candle. In normal HA candles this is not user changeable.

Here I want to talk about **heiken ashi dojis** which more or less **represent what a normal candle doji shows. I have found these to be good reversal signals and although good trades do come from other candle patterns I believe they are worth watching out for**.

With a HA doji you may or may not see a change in colour of the candle but the body of the candle will be quite small and there will be wicks, usually quite long wicks, at BOTH ends of the candle. These signals are strongest when they occur after a nice smooth move in one direction against the trend and the doji forms signalling a move back in the direction of the trend although they are good signals in non-trending markets too.

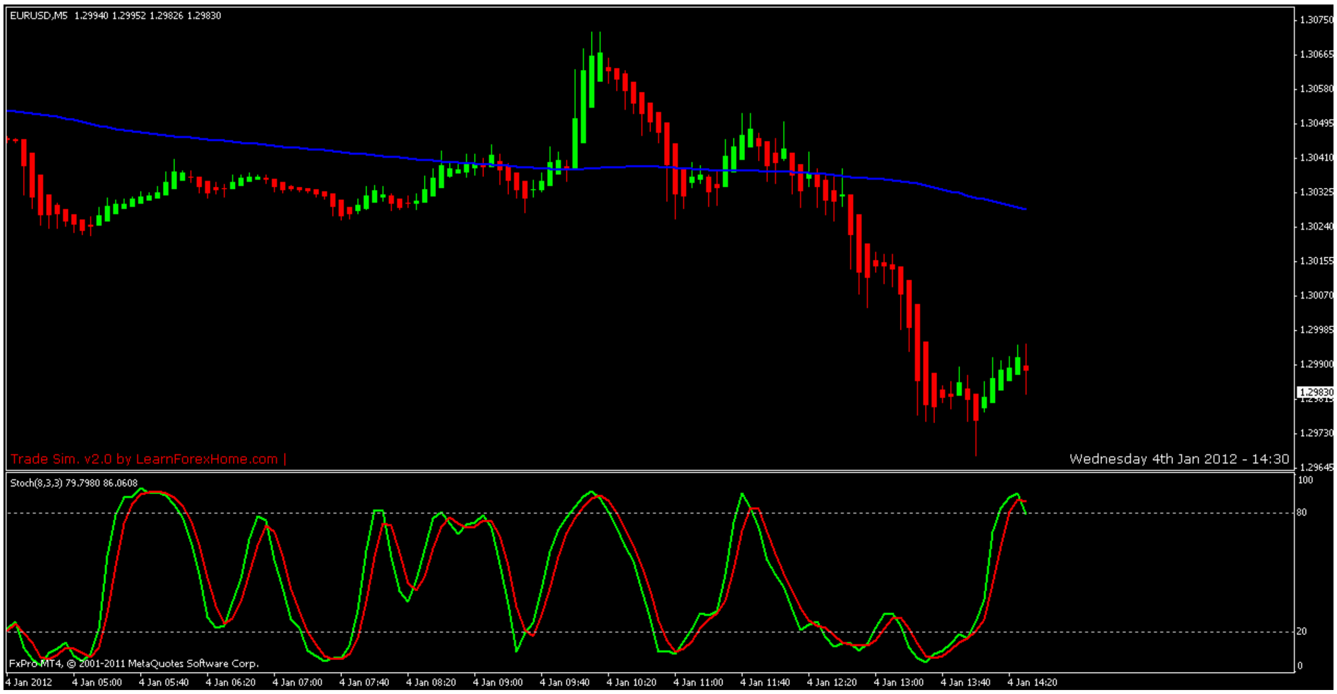
I have attached some screenshots. The first one is a 5 minute chart of eurusd on the simulator. I've used this so I can show you in real time what these candles look like as they set up. You can see the stochs crossing at the top after a smooth pullback against the trend and the HA colour changed from green to red. There are fairly large wicks at both ends of the candle.

The second chart is immediately at the open of the new candle. As the actual price closed towards the lower end of the doji the real body of the next candle opens as a quite large red candle. This is the entry point.

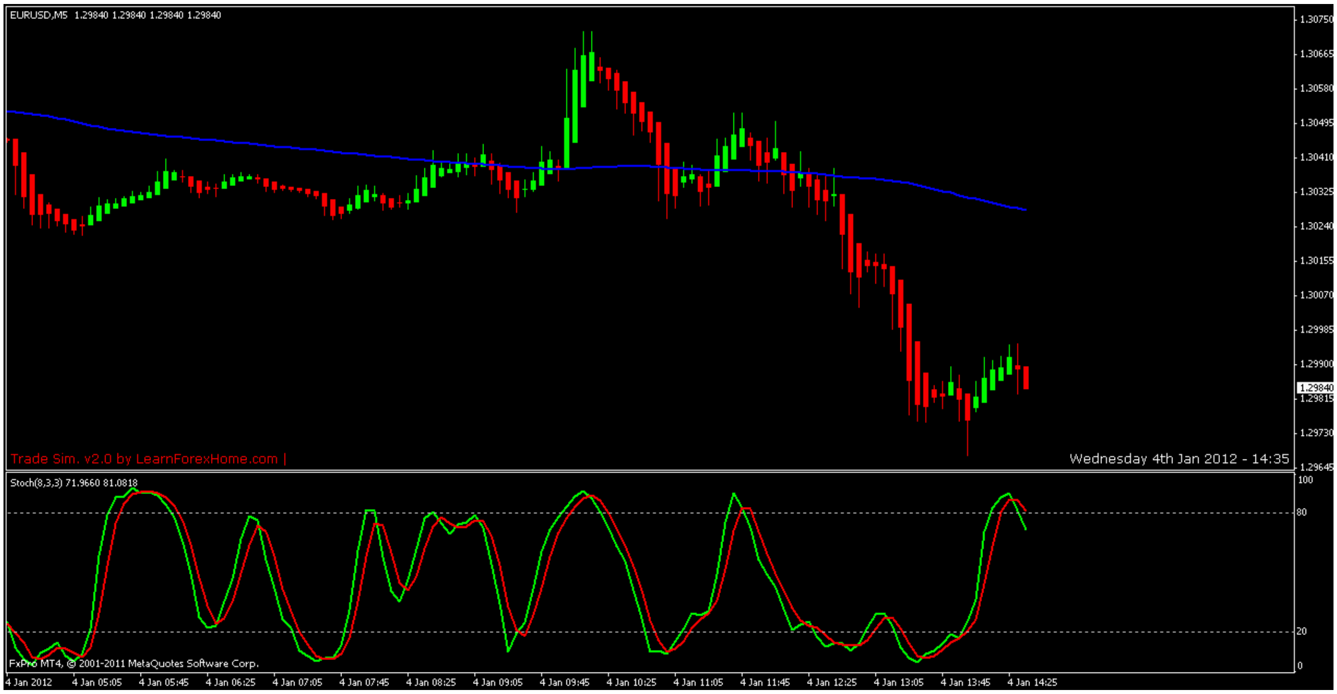
The third chart is a while later. You can see we had a nice move with the trend but a candle posted green and the stochs have crossed at the bottom and are heading up. Time to either close the trade with a profit or at the very least move the stop loss very tightly behind those candles in case the trend takes off south again without pulling back much farther.

This is just one example that didn't take that long to find and illustrates what I want to get across perfectly. I hope this post has helped someone? Until tomorrow.

EURUSD, 5Min



EURUSD 5Min continued...



Note:

Joeyd is kind enough to provide us with a **HeikenAshi Doji Spotter**, refer to post#33 to download here is the link:
http://www.forexfactory.com/showthread.php?t=340556&page=3

Hugh Briss' thoughts on 100MA (Post#26)

The **100 SMA i**s just a more or less randomly chosen number. I've read here and there that a lot of traders use it so just went with that. **The actual number you use is less important than how you use it.** You could use an 80 ema and get a similar picture. It is literally just for a visual aid. You could also use it to say only buy above and sell below.

There are always good moves against the trend but they are less easy to predict and therefore trying to trade them is lower probability. If you look through the charts you will see that when the ma is trending strongly then the smoother and longer moves tend to be with the trend and that is why I concentrate on them.

Hugh Briss' thoughts on Indicators (Post#123)

Don't fall into the trap of always looking for the perfect settings. **A trading system will always have losses and you will never "filter" them all**. You'd do better to **concentrate on one or two indicators and frankly it makes no difference which ones you use**.

I like to use heiken ashi because they look smooth on the chart. I like the 100 sma because it makes it easy to immediately know the trend. I like the stochastics because they give me information about the strength of the pullback and the change in momentum from down to up and up to down. When I put the three together and only trade with the trend then I have a very good probability of the trade going in my favour, at least for 25 pips to get to break even.

You can use any indicators you like but don't spend too long worrying about what indicator with what settings. **Learn the limitations of the indie you are using, learn what to look for in a good trend and then just trade it**. You will never find the perfect indicator. **Money management is much more important than the method.**

Hugh Briss' thoughts on Trend slowing down (Post#173)

I think we are entering a difficult period for trading the 4 hour charts due to trends slowing down and possibly reversing. **The signal works well on any timeframe as long as you adjust your stops and targets**. **Find a pair that is trending smoothly in any timeframe and then wait for a smooth pullback and a smooth stoch cross back in the direction of the trend**. **It is high probability wherever it happens**. Notice the keyword is smooth, **if the heiken ashi candles are all over the place then just leave it alone.**