Using Swing Highs And Swing Lows To Better Understand What's Taking Place In The Market

Introduction

The key to making consistent profits from the forex market is being able to understand why something has taken place. Everything you see on your charts from the candlesticks to the swing highs and swing lows have formed for a reason, knowing the reason why these things have formed allow you to come up with a much clearer picture of what is taking place in the market along with what might happen in the near future.

Unfortunately most traders don't know why the things they see on the charts occur. Almost all are able to register when something like a candlestick pattern has appeared, but few will be able to tell you what has actually caused the pattern to form in the market.

The same can be said for swing highs and swing lows.

All traders can identify when a swing low or high has formed but virtually none can tell you what action has caused the low or high to form on the charts. If traders knew the reason why swing lows and swing highs form, it would allow them to make much better decisions in regards to determining which direction the market is likely to move in and where they should be placing trades.

By the end of this book you'll know the reason why swing lows and swing highs form in both up-trends and down-trends, along with how you can determine which swings are more important than others by analysing the amount of buy or sell orders that were coming into the market at the time the swing itself was created.

Also I'll run through two examples of how you could have used this new understanding of swing highs and lows to anticipate both a trend reversal and a trend continuation.

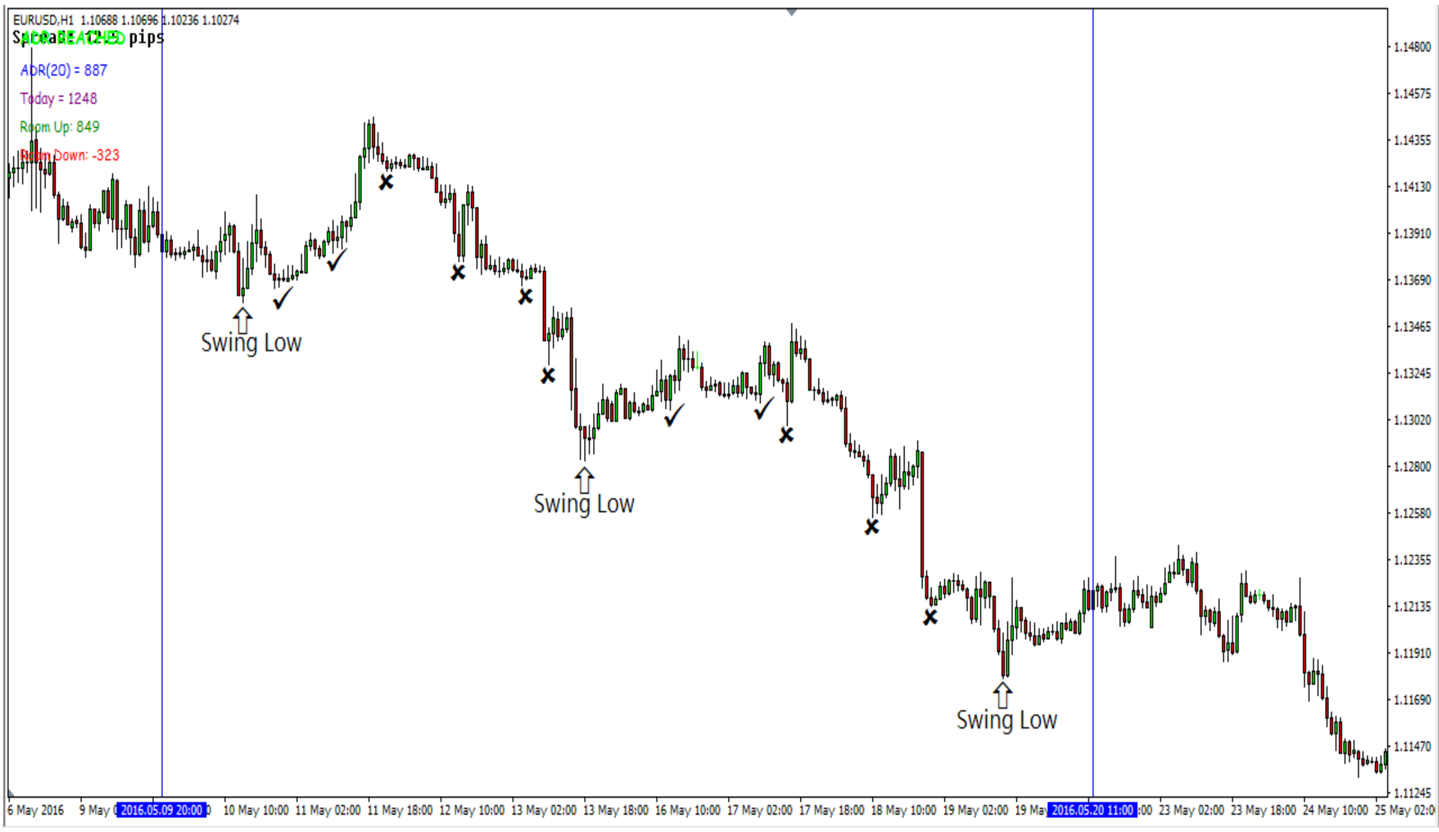
Hope you enjoy the book.

What Causes Swing Lows And Swing Highs To Form In The Market ?

Swing highs and swing lows are found all over our charts. Everyday we are guaranteed to see at least one swing low and one swing high form in the market yet the funny thing is, I don't remember reading one single trading book or article that tells me the reason why swing lows and swing highs are forming on my charts ?

Over the course of this chapter I'll explain why swing lows and swing highs form in the market. You'd be happy to know that it's actually quite simple to figure out why a swing low or high has formed, all it requires is an understanding of when and where the banks can take profits and place trades as it's these two actions that cause swing highs and lows to form on our charts.

Let's begin by taking a look at what causes swing highs and lows to form when the market is in a downtrend or making a swing lower.



Here we have an image of a down-move that took place on EUR/USD.

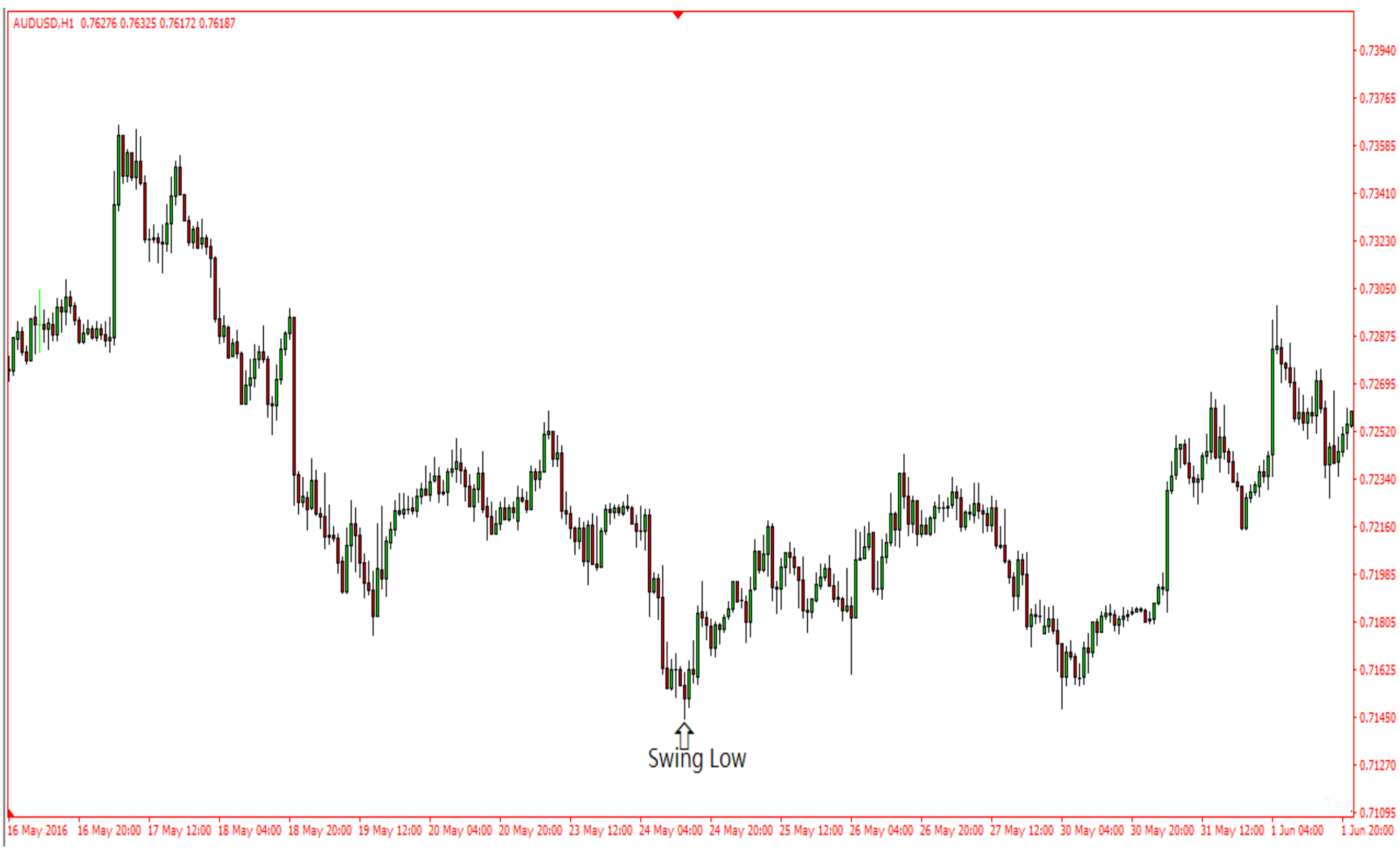
You can see I've marked all the swing lows which formed in between the two vertical blue lines. *(Note: there might be a couple I've missed)*

All of the swing lows which I've marked with X's and arrows formed for the same reason. That reason was because the bank traders were taking profits off the sell trades they had placed during this move lower.

When the market is moving lower, the banks can only take profits off sell trades when there is a large number of additional sell orders coming into the market. Sell orders enter the market from other traders placing sell trades, the point where a large number of traders enter sell trades is the point which ends up turning out to be a swing low.

The three swing lows which I've marked with arrows are far more important than the other swing lows I've marked on the image. I'll show you later on how to determine the importance of a swing low and swing high but for now just know that when I say major swing low (or major swing high for the next chapter), know that I mean a swing similar to the three I've marked with arrows in the image, ones which cause a clear change in the market structure.

Note: You'll notice I've marked four swing lows with ticks. These swing lows are different to the others in that they have formed not because of the bank traders taking profits off sell trades, but because intra-day bank traders were placing long trades to make money. (More on this in the next chapter)



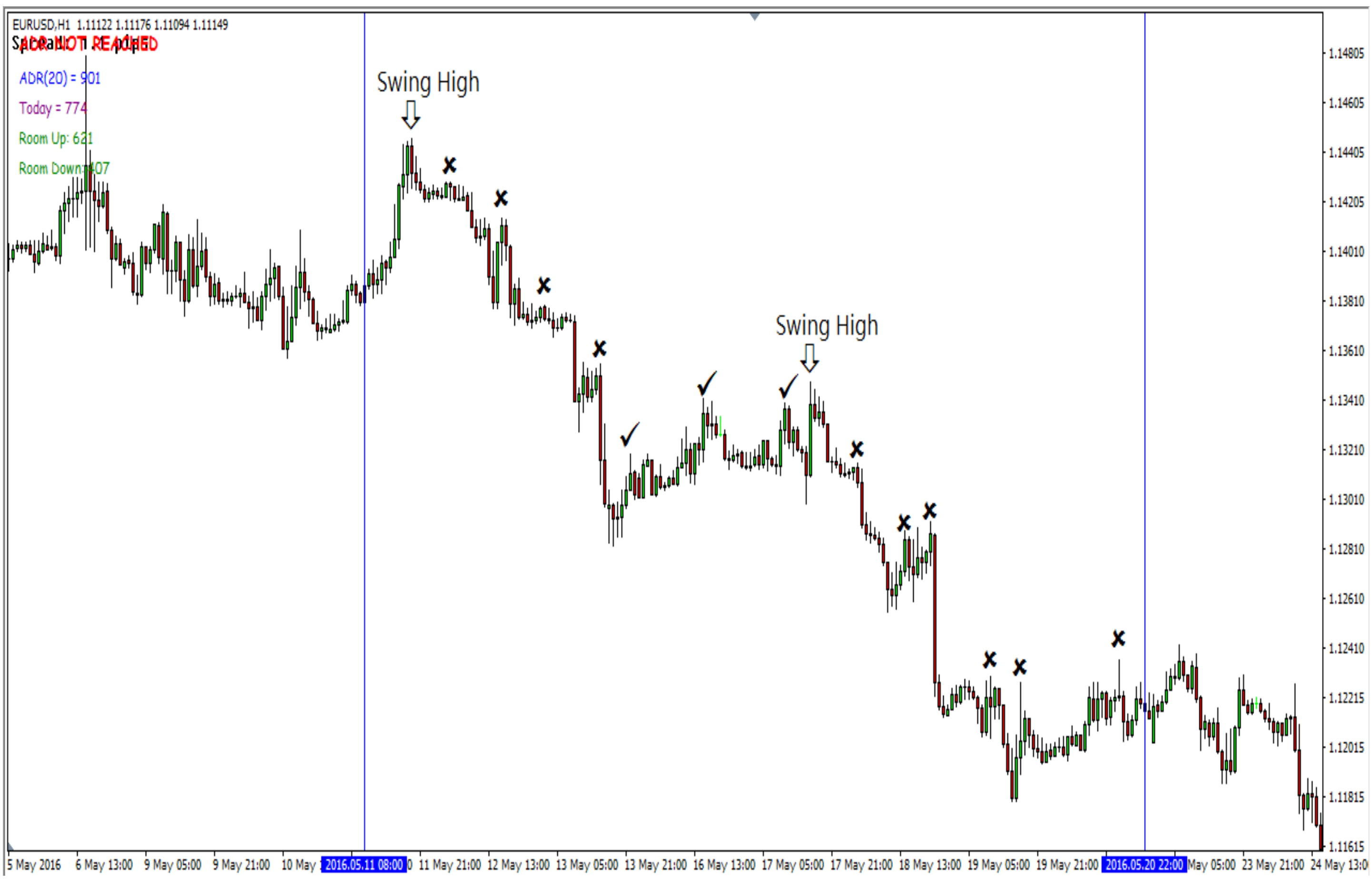
Here's an example of a major swing low which formed because of the bank traders placing buy trades to make the market reverse. Usually all major swing lows in down-trends will form because of the bank traders taking profits off sell trades, but there will always be at least one that forms due to the banks placing buy trades to make the market reverse.

Of course we know this after the fact but at the time we wouldn't be able to determine if the swing had formed due to the bank traders placing buy trades or because the bank traders were taking profits off sell trades.

This leads us onto a really important point........

When we see a major swing low form during a down-move or down-trend, we can not automatically assume it has been created by the bank traders taking profits off sell trades. We must understand that there exists a small possibility of the swing being created due to the bank traders placing buy trades to make the market reverse.

All down-trends and down-moves will end with a swing low that has formed due to the bank traders placing buy trades, there is no way to tell beforehand when this swing low will appear but we for sure that it will appear at some point.



Here's the image I used to show you the swing lows only this time, instead of marking the swing lows, I've marked all the swing highs.

The major swing highs are marked with arrows the same as you saw in the last image and the less important highs are marked with X's and ticks.

Now all the swing highs (minus the ones marked with ticks) have formed because of the bank traders placing sell trades into the market. These are the same sell trades the banks are taking profits off that cause the swing lows we've just looked at to form in the market.

When the banks want to get sell trades placed they need to have buy orders coming into the market. These buy orders will come from traders placing buy trades. The only time a large group of traders will be placing buy trades is when the price is rising, when it's falling most will be placing sell trades which means the banks will not have enough buy orders coming into the market to get any of their own sell trades placed.

You can see how all the swing highs form when the market makes a moves up and then makes a move down. The reason it's moved down is because the banks have placed sell trades into the market using the buy orders that were generated from traders buying because of the move up.

In the previous chapter you'll remember there were some swing lows which I said formed because of the intra-day bank traders placing long trades to make money.

The three swing highs which I've marked using ticks in the image on the previous page,have also formed because of the intra-day bank traders, only this time they're taking profits and closing the long trades they'd placed at the swing lows.

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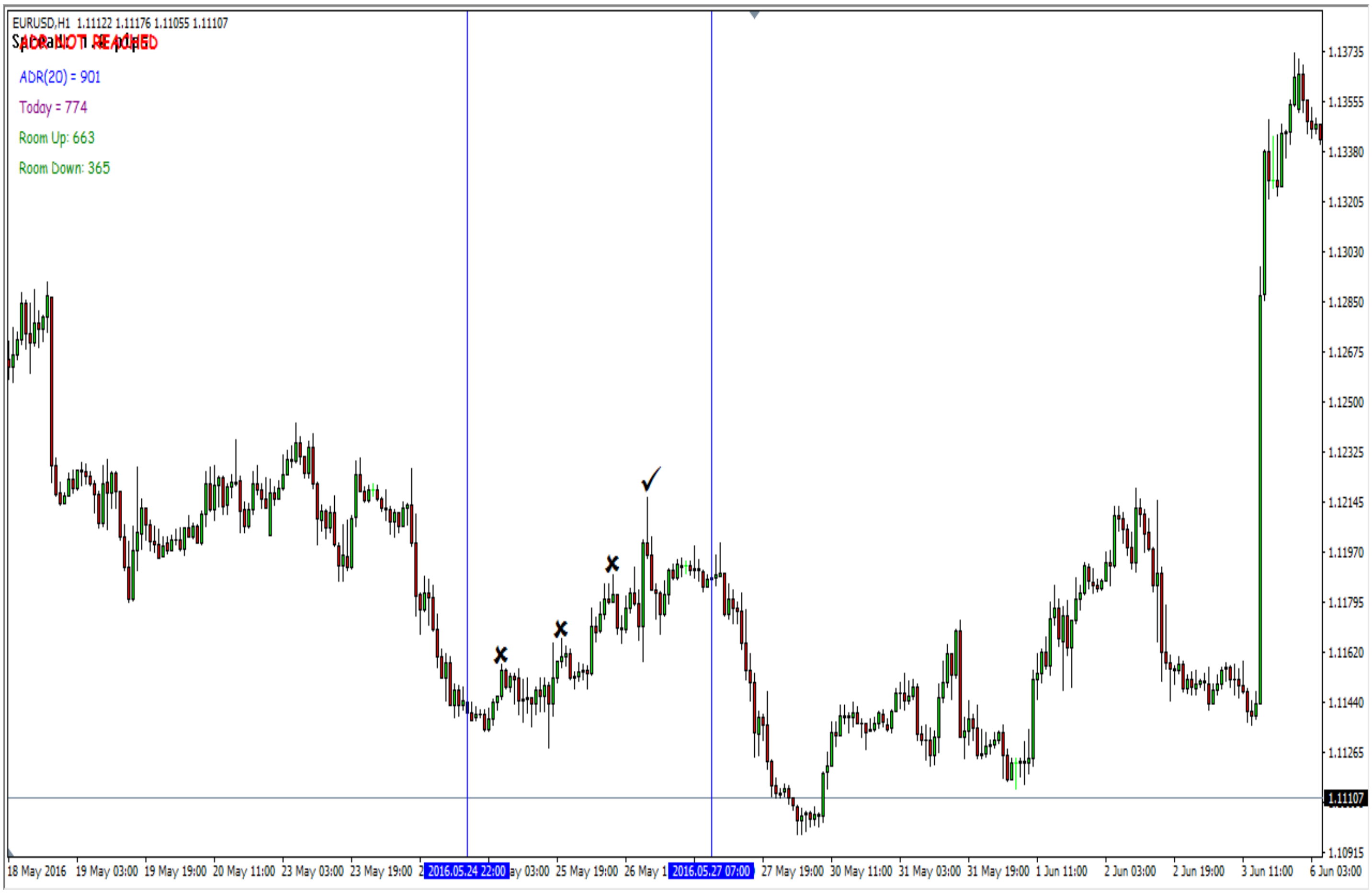
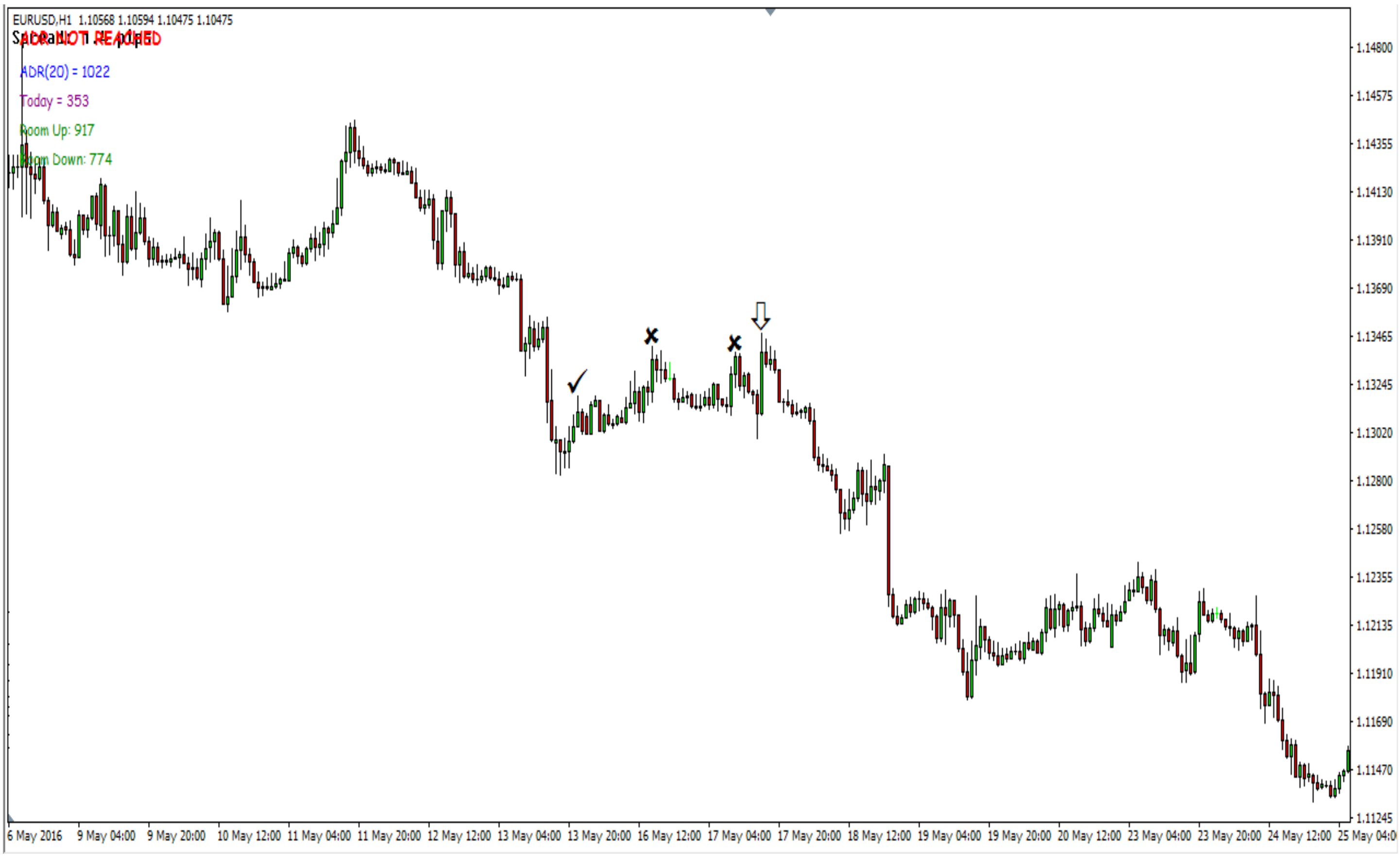


Here's a retracement that occurred a short time later in the same down-move seen in the previous images.

Notice how there are four swing highs that form during this retracement ?

Three which I've marked with X's and one marked with a tick. The high I've marked with a tick is the only high which has formed because of the bank traders placing sell trades into the market, the other three highs have all formed due to intra-day bank traders taking profits off buy trades placed at the swing lows that formed during this small retracement.

The only time swing highs that form during retracements in down-trends are not created by the bank traders taking profits off sell trades, is when all the highs are found at prices which are close together.



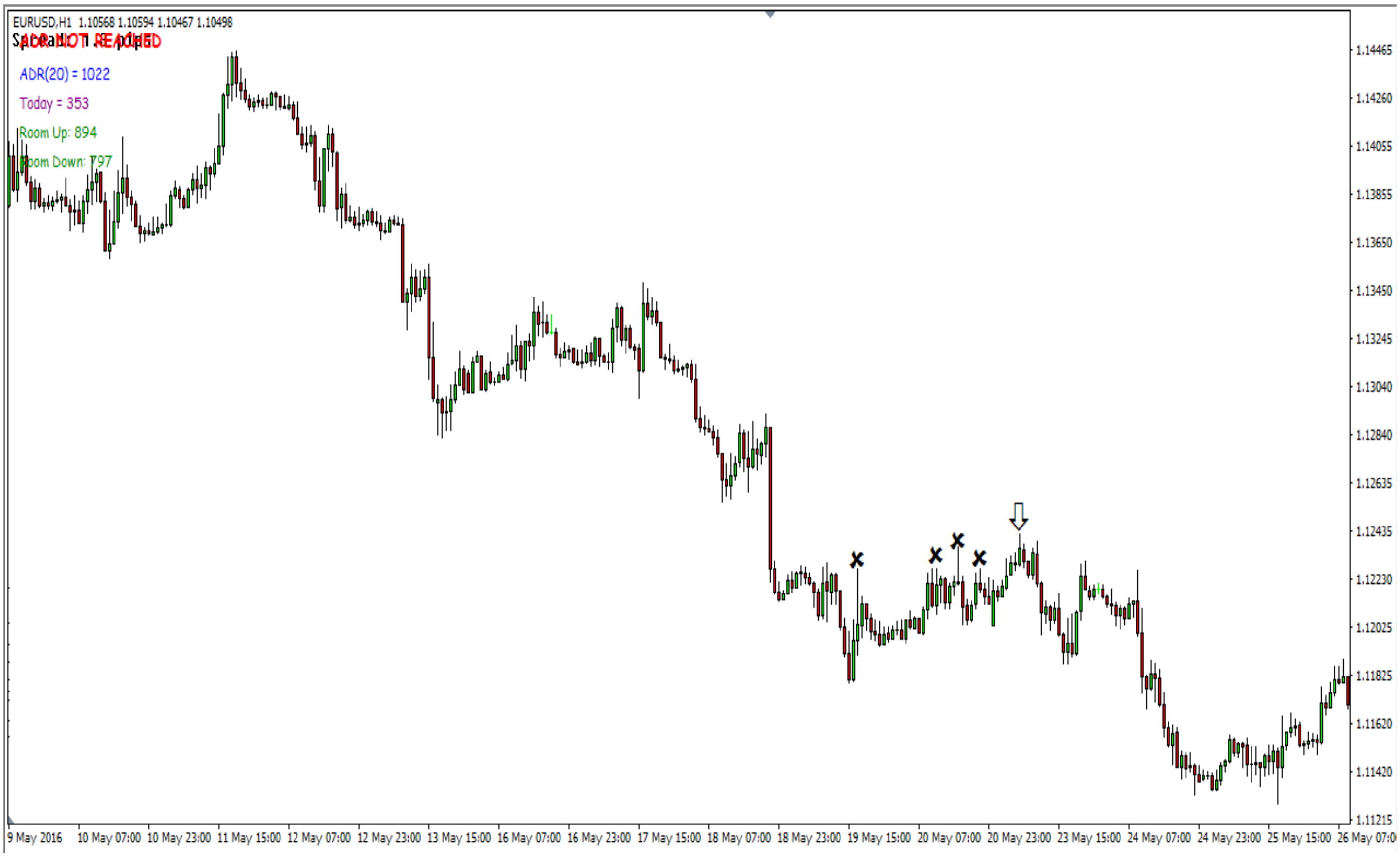
Here's the image I showed you earlier of the swing highs I marked with ticks.

I said these highs (minus the one with the arrow) were created by the intra-day bank traders taking profits off long trades they had placed at the swing lows but really that can only be said to be true for the swing high I've marked with a tick.

The highs marked with X's are far more likely to have formed due to the bank traders placing more sell trades into the market. The reason I say this is because of the fact both swing highs are found at prices which are close together.

Anyone who has read my book on “How The Large Institutions Operate In The Forex Market” will know that when the banks are getting multiple trades placed in the market, they will tend to get them placed at prices which are close together because it makes it much easier or them to calculate how many opposing orders they'll need to take profits off their trades once the price starts to move in the direction they were anticipating.

You can see the same thing take place during the next retracement.........



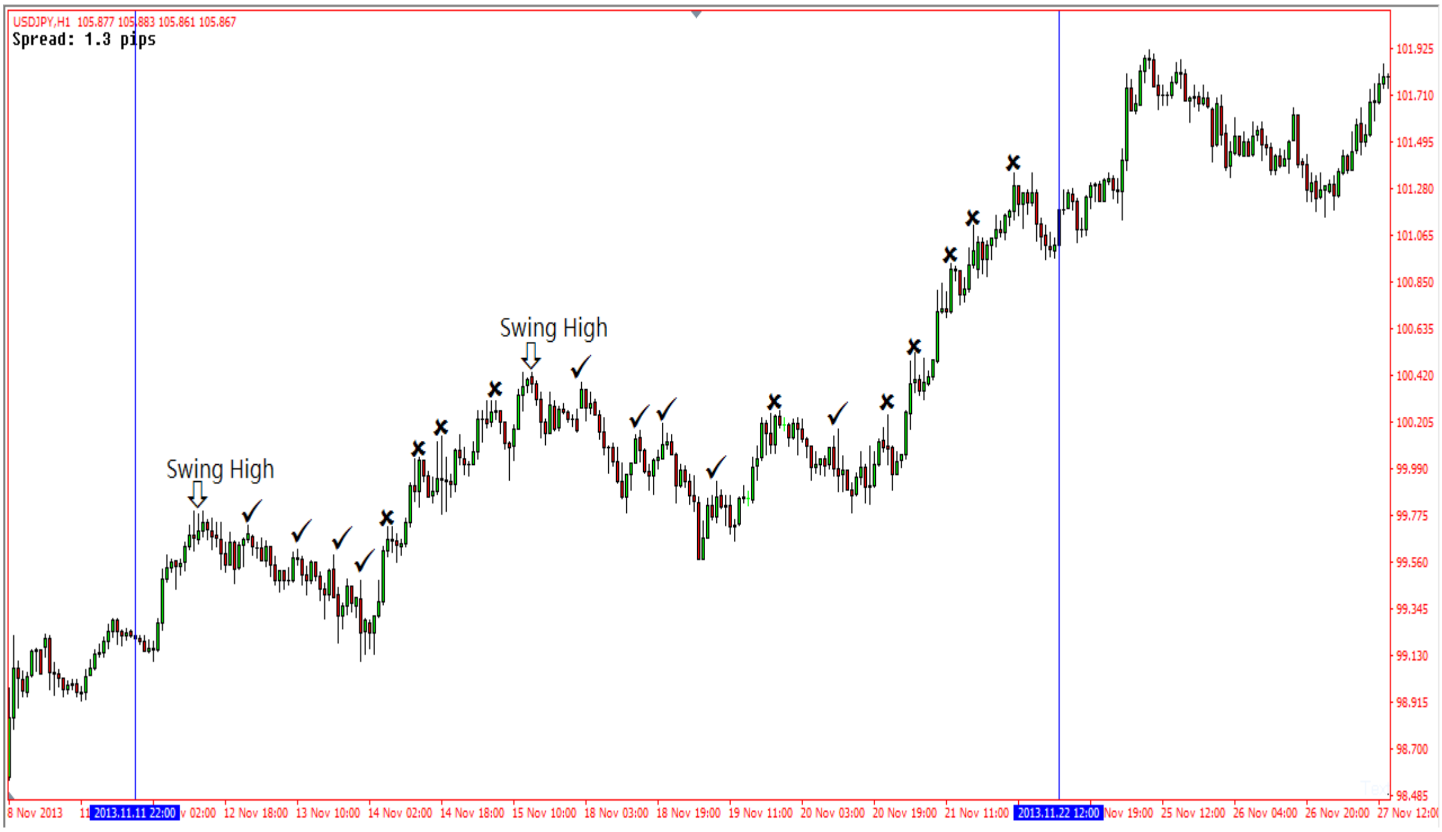
The swing highs we see form during this retracement are also more likely to have been created due to the bank traders placing sell trades rather than intra-day bank traders closing long trades because of the fact they are all found really similar prices.

Note:

The high marked with an arrow does not count as it's a major swing high. A major swing high in a downtrend is always caused by the bank traders placing sell trades to capture a continuation of the move lower.

What Causes Swing Lows And Highs To Form In Up-Trends ?

Now we've taken a look at the causes swing lows and swing highs to form during down-trends we're going to move on to looking at what causes them to form during up-trends.



Here we have an up-move that took place on EUR/USD.

You can see I've marked all the swing highs that formed during the move up marked between the blue lines. All of the swing highs marked with arrows and X's formed because the bank traders were taking profits off long trades that had been placed earlier on in this move up.

Now the highs that have been marked with ticks have formed because of the intra-day bank traders placing sell trades.

The reason these short trades have been placed is because the objective of the intra-day bank traders is to make money from the markets every day. On some days the market will be in a retracement which means the intra-day traders will need to get trades placed in the direction to which the retracement is occurring if they are to end up making money during that day.

Here's the previous image but with the swing lows marked instead of the swing highs.

All of these swing lows minus the ones which are marked with ticks have formed due to the bank traders placing buy trades. The lows marked with the arrows are the major swing lows that formed because of the bank traders placing large buy trades into the market.

The other swing highs marked with X's also formed because of the bank traders placing buy trades only the size of these buy trades were much smaller than the buy trades that were placed at the major swing lows marked with arrows. (More on this In the next chapter)

The swing lows that form at the points marked with the ticks, have all been created by intra-day bank traders taking profits off sell trades and closing sell trades placed at the swing highs that formed during the retracements.

How To Determine The Importance Of A Swing Low Or Swing High

Now we've seen what causes swing lows and highs to form in the market, the next task is for me to show you how to determine which swing lows and highs are more important than others as this is essential for you being able to pick up on early changes in the market direction.

When traders are looking at their charts, they don't realize that some of the swing lows and highs they're seeing form are much more important than others. They mistakenly assume all swings high and lows are the same in the sense they all hold equal importance in the market.

This is couldn't be further from the truth !

Some swing lows and highs are far more important than others due to the action that caused the swing high or low to form.

In the previous chapter we learned how swing lows and swing highs can only form because the bank traders are either taking profits off trades they've already got placed or because their placing trades to make the market reverse.

Both of these actions require buy or sell orders to be coming into the market.

How many of these orders are coming into the market will determine the amount of profit the banks will be able to take off their trades and the size of the trades they'll be able to place if they want to make the market reverse.

Knowing the size of the trades placed by the banks, or the amount of profit they have taken off their trades is invaluable because it allows us to filter out the possibilities of what the market may or may not do upon reaching a swing high or low.

As an example lets say three swing highs formed in the market because of the bank traders placing sell trades. If we knew the banks had placed most of their sell trades onto one of the three swings then we'd know that swing is far more important than the others because of the fact the banks will not want the market to break through the point where a significant number of their trades have been placed.

If the market was to break past the two other swing highs that formed, we would know it's unlikely to be a reversal taking place as the swings formed due to the bank traders placing sell trades that were far smaller than those which were placed at the other swing high.

Now the first step to understanding which swing highs and lows are more important than others is to figure out how many buy or sell orders were coming into the market at the time the swing high or low was created.

Obviously we cannot determine the exact amount in terms of numbers but we can compare swings to see if there were more orders coming into the market when one swing formed vs when another swing formed.

Take a look at the two swing lows marked above.

Both of these swing lows formed because of the bank traders taking profits off sell trades placed earlier on in the move down.

The main difference between the two swings is the banks ended up taking more profits off their sell trades at the first swing low, than they did at the second swing low, because of how many sell orders were entering the market at the time the first swing low was created.

Here's an image of what the market looked like right before the first swing low formed in the bottom right hand corner of the image.

What's immediately obvious is how bearish the market looked before the swing low was created.

To a typical retail trader the chart above makes it look like the market is certain to

continue moving lower. What this tells us is there would have have been a large number of traders placing short trades into the market right before the swing low formed in the bottom right of the image.

What this means is at the point where the first swing low formed, the majority of orders coming into the market would have been sells, very few traders would have been placing buy trades because of how bearish the market looked.

Now lets take a look at what the market looked like before the second swing low formed and you'll see how there were far fewer sell orders coming into the market than there were at the time when the first swing low formed.

Here's an image of what the market looked just before the second swing low formed.

It's evident the move up from the first swing low makes the market look a lot less bearish than it did before the first swing low formed.

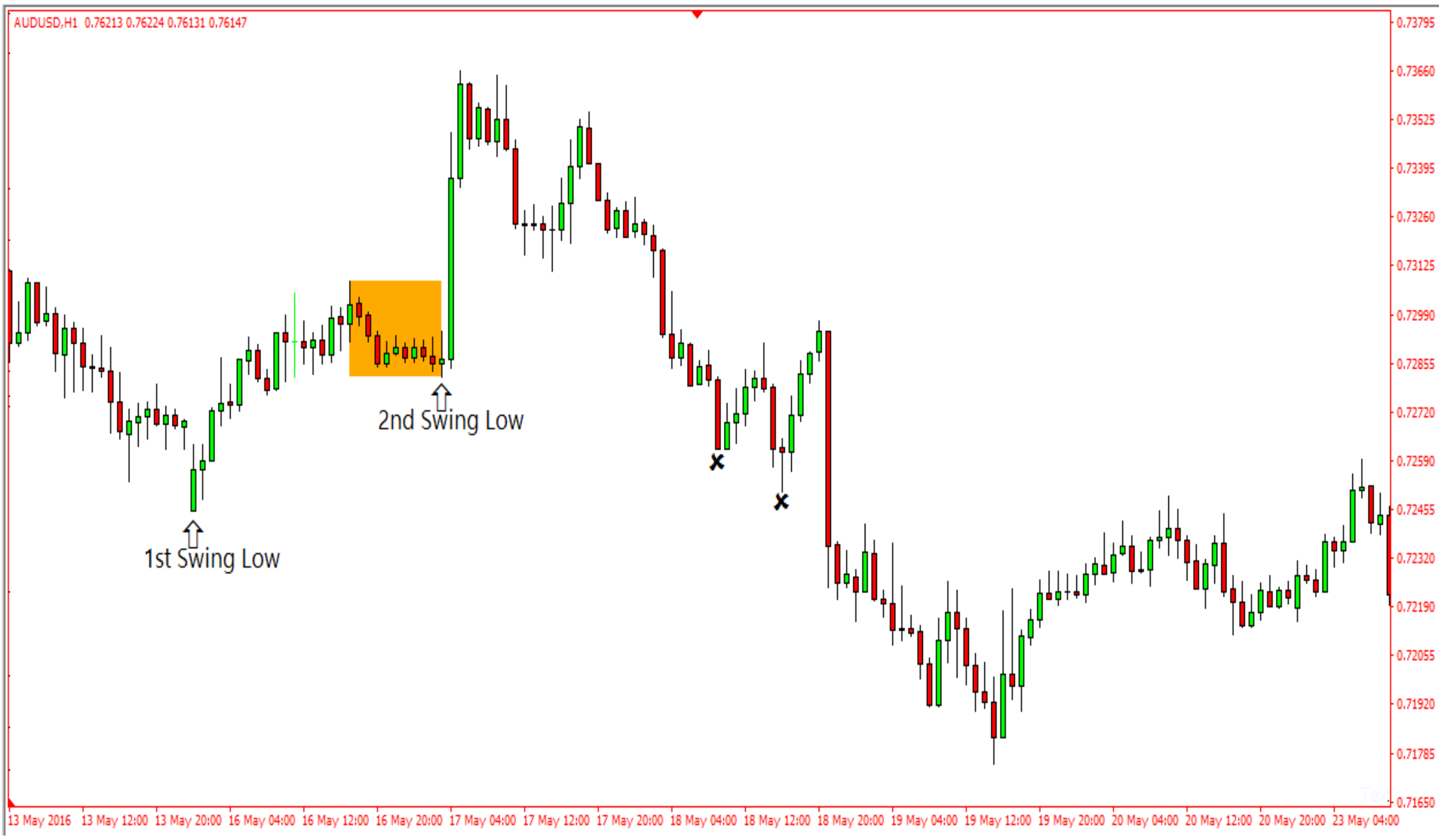
The move up will automatically cause people to start placing buy trades because a certain portion of traders will believe the move up is a sign the market is beginning to reverse. This means there were a much smaller amount of sell orders coming into the market at the point where the second swing low formed, than there were at the point where the first swing low formed.

The amount of profits the banks could potentially take off their sell trades was dependant on how many sell orders were coming into the market at the time they wanted to take profits.

Because there was a much bigger amount of sell orders coming into the market at the point where the first swing low formed, it meant the banks were able to take a substantially larger amount of profits off their trades than they were able to at the time when the second swing low formed.

This makes the first swing low far more important to the market structure than the second swing low. The reason why is because when the banks are taking profits off their trades they'll typically not have enough buy or sell orders coming into the market to take all of the profits they want off at one price. Instead they'll have to wait until the price is falling or rising again before having enough orders available to take the rest of the profits off their trades.

The point where they will have enough orders available will be very close to the point where they took their previous batch of profits.



If we look at what happened once the market began to fall we can see some buying started to enter the market near the point where the first swing low had formed.

This small bit of buying (marked with X's) is from the bank traders taking the remainder of their profits off the sell trades which they were unable to do at the time the first swing low was created due to the fact not enough sell orders were coming into the market.

The reason they do this near the first swing low rather than the second, is because the number of people placing sell trades by the time the price is in close proximity to the first swing low is much higher than the amount of traders placing sell trades when the market reaches the point where the second swing low had formed.

Most of the down-movement from the swing high to the 2nd swing low has been created by retail traders who went long closing their trades at a loss. The sell orders generated by this are not the same as people coming into the market and placing sell trades, which is why the banks must wait until the market has dropped into the region of the first swing low before taking the rest of the profits off their trades as by this point a lot more traders are beginning to get short trades placed because they're anticipating a break of the swing low.

Another thing to take into account is what has caused the swing low to form.

In the image we know both swing lows formed because of the bank traders taking profits off sell trades but we would only know this AFTER the fact. At the time there wouldn't be any way for us to tell if the swings had formed because of the bank traders taking profits or because they were placing trades to make the market reverse.

Regardless of what may have caused the swing lows to form the main concept remains the same, the size of the trades the banks can place and the amount of profit they can take off their trades, is determined solely by how many orders are coming into market.

So even if both swing lows had formed due to the banks placing buy trades the first swing low would still be more important than the second due to the fact the size of the buy trades placed by the banks, which caused the first swing low to form, would still have been much bigger than the size of the buy trades placed at the second swing low due to the amount of sell orders that were entering the market at that time.

Now let's do a quick run through of how you can determine the importance of a swing high in the market.

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The two swing highs seen in the image above formed because of the bank traders taking profits off buy trades.

Just like in the previous example, the first swing high is considered to be more important than the second because of the amount of profits the banks took off their trades when the first swing high formed.

There were a significantly larger amount of buy orders coming into the market when the first swing high formed than there was when the second swing high formed because of how bullish the market looked just before the first swing high was created.

The first swing high was created right after a large move higher had taken place.

This move higher would have caused a huge amount of retail traders to enter buy trades as they will have thought the price is going to keep moving higher due to how steep the move higher itself was.

When the second swing high forms the market has already made a move lower which would've caused some traders to begin going short as they think the down-move is the start of a reversal.

This means when the price rises up, and the banks start to take more profits, they do not have as many buy orders coming into the market as they had when the price was rising before the first swing high formed, therefore they are not able to take as much profit off their trades as they were when the first swing high was created.

The easiest way to determine which swing lows and highs are more important than others, is to look for the swings that mark an obvious change in the market structure.

In the previous image you can see the first swing high marked the point where the market stopped advancing higher and began consolidating.

If you go back a couple of pages to where we were looking at the swing lows that had formed because of the bank traders taking profits, you'll see the first and most important swing low marked the point where the market changed from falling lower to retracing higher, this is how you know the swing is more important than the others.

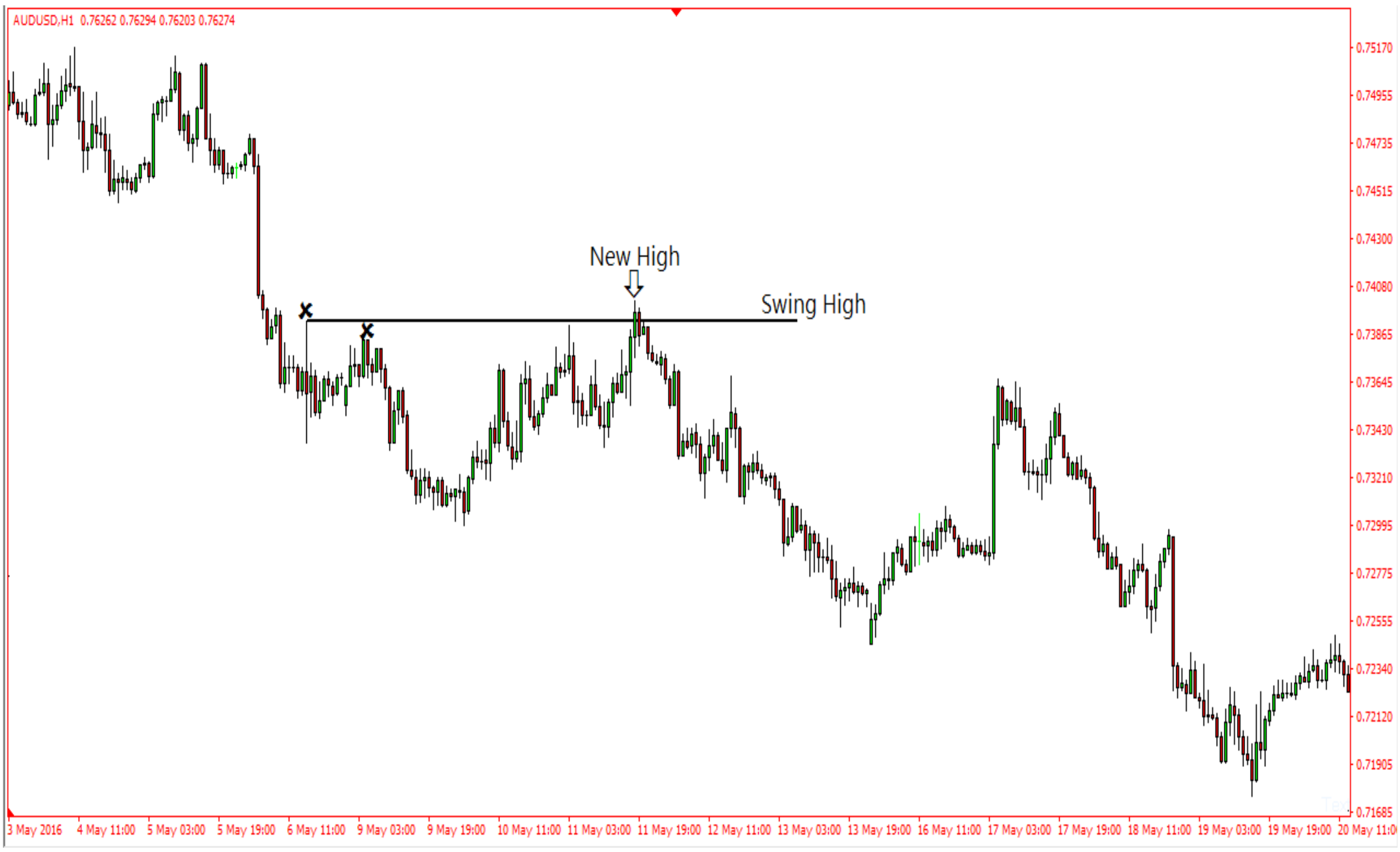
The Reason Why So Many False Higher Highs And Lower Lows Form In The Market

Something which you will have no doubt noticed if you determine the direction of the trend using the “higher highs - lower lows” part of the Dow Theory, is that sometimes the market will make a higher high or lower low and instead of moving in the direction to which the higher high or lower low suggests, it goes and moves in the opposite direction.

Example:

EUR/USD is in a downtrend. A move higher causes a previous swing high to be broken by a new swing high, this is supposed to indicate a possible change of trend but a short time later we see the market fall to new lows.

Nobody can seem to offer an explanation as to why this happens. If you have ever read any books on the Dow Theory you'll see for the most part they never even mention the fact this takes place in the market which is strange because it's a huge flaw in the whole concept of using higher highs and lower lows to determine the direction of the trend.



The image on the previous page shows the market breaking above an old swing high before swiftly moving back in the direction of the trend.

Common trading books state a trend change is signified by the market breaking through old swing high or low as it's supposed to tell us people are willing to transact at new prices in the market.

When traders see the market break a swing high or low weather it be by 100pips or 1pip, they assume a possible trend change is taking place. In the image we can see how the market made a new high which was higher than the swing high found at the top of the previous drop. This new high was supposed to signal to us the market might be changing from a downtrend to an up-trend, yet as you can see, once the high is made the price starts to drop until it has fallen through the swing low created by the move up.

It would be at this point where the traders get confused. The new high was supposed to indicate further up-wards movement but the traders have just watched as the market failed to continue moving higher and instead fell down and broke though the swing low.

The reason why so many false swing highs and swing lows appear in the market is because of what causes swing lows and highs to form in the first place.

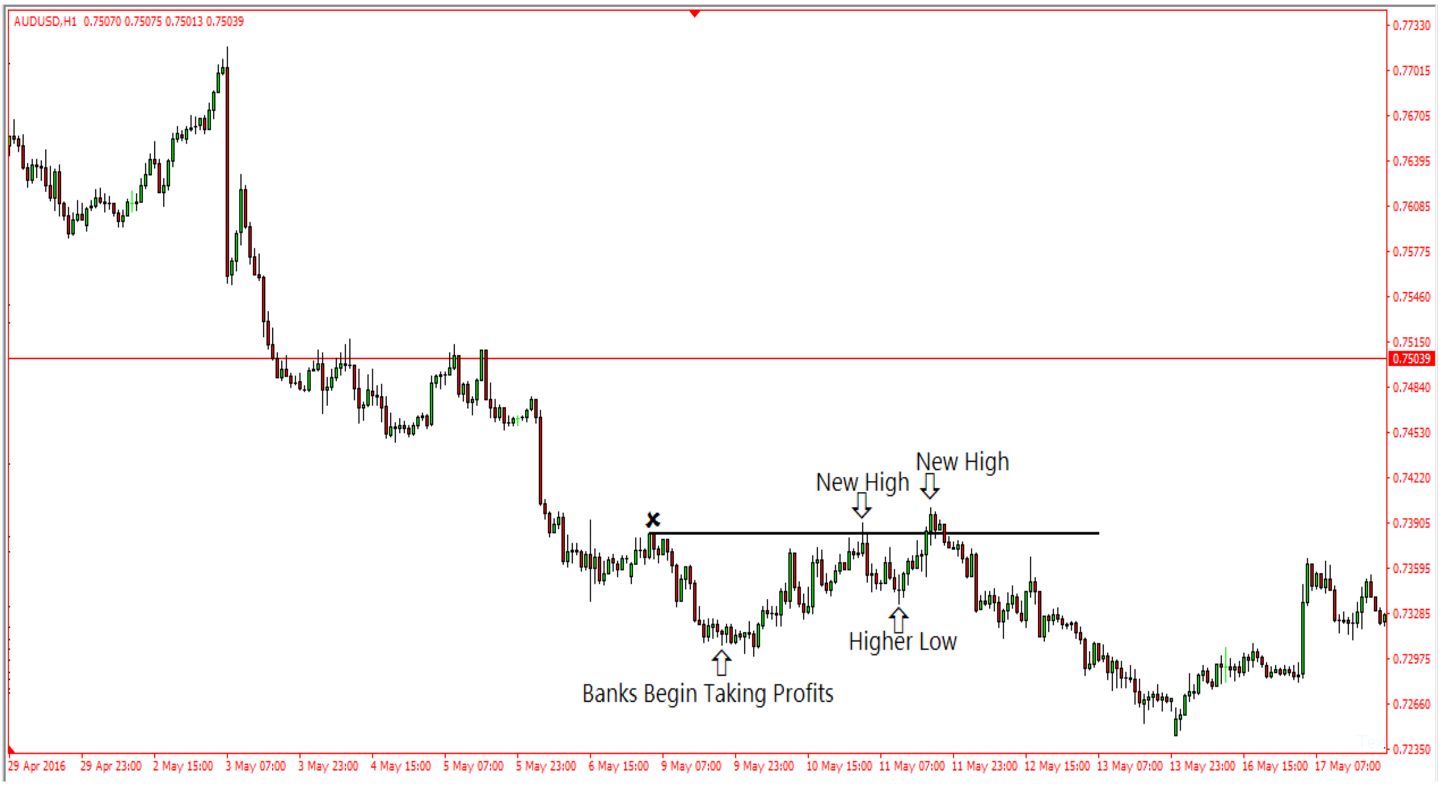
At the beginning of the book I showed you how swing lows and swing highs form because of the bank traders either taking profits off their trades or placing trades to make the market reverse. Now the key thing to understand is whenever you see a false swing high or low form, it will be because the bank traders have placed trades to make the market reverse, not because they're taking profits off trades they already have placed.

Their placing trades either to make the market reverse or to cause a continuation of the current movement, really it doesn't matter. The important thing is that you know how the banks place their trades into the market.

When the banks are getting trades placed, they never have enough orders in the market to get all of their trades placed at one price, this means they have to make the market move up or down to purposely get other traders to place buy or sell trades in order to generate enough orders for them to then use to get any of their remaining trades placed.

The really important thing to understand is these remaining trades will be placed at prices which are as close together as possible.

The reason why is because having all their trades placed at close prices makes it much easier for the banks to calculate how many opposing buy or sell orders they'll need to take profits off their trades once the market actually reverses.

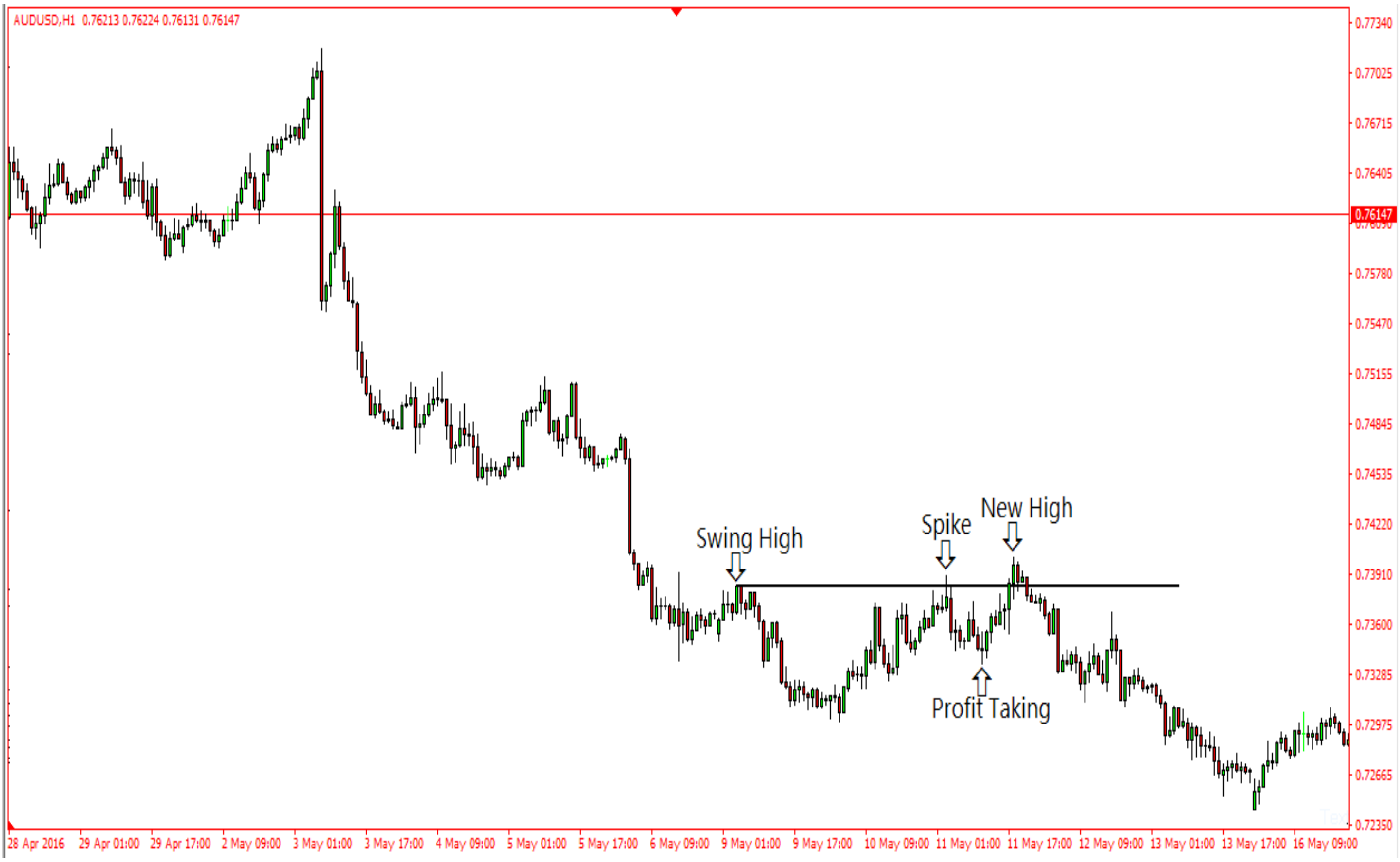


In the image above we can see the banks had placed sell trades at the swing high marked with an X. We know they placed sell trades here because this was the only time a large number of buy orders came into the market during this retracement.

What we didn't know was the banks had been unable to get all of their sell trades placed during this retracement, there were some left which they couldn't get placed because there were not enough buy orders coming into the market.

This meant the banks had to make the market move back up after it had fallen from the high marked with an X in order to make traders place buy trades and thus put buy orders into the market which the banks will then be able to use to get the remainder of their sell trades placed.

To make the market move back up the bank traders take some profits off the sell trades they have already got placed at the swing high. What this does is consume all of the sell orders coming into the market from other traders placing sell trades which causes the market to start moving higher.



Eventually the profit taking has caused the market to return to the swing high where the banks placed their sell trades that caused the price to drop lower. The market then proceeds to spike through the high before falling again. This drop is caused by the bank traders placing more of their sell trades into the market using the buy orders that have been generated from people placing buy trades because they have seen the market move higher.

The spike means the market has now made a high which is higher than the previous high, at this point most traders would be thinking the market might potentially be changing from a downtrend to an up-trend, the only thing left we need to see in order to confirm this is a higher low.

A few hours after the spike, the market has stopped falling and is beginning to move higher again.

This move up has also been caused by the bank traders taking profits off sell trades. The reason they're doing this is because they still have some sell trades left they need to get placed, the only way these sell trades can be placed is if there are buy orders coming into the market from people placing buy trades.

The move up manages to breach the previous high by about 10 pips, this means we now have a higher high and higher low in place in the market. As far as the

Dow Theory is concerned, the market has reversed and instead of being in a downtrend we are now is an up-trend.

Then we start to see the market fall, again this is normal right until the point where the market manages to break through the higher low that was made by the banks taking profits off their sell trades, this is where the Dow Theory starts to break down.

The new high was supposed to mean the market had reversed, the higher low only sought to confirm this further. When the market then goes and falls through the higher low, it means the market has now reversed again as the new low is a sign of more downside movement, therefore the higher high and higher low didn't actually signal a change of trend because the downtrend continued soon after they had formed.

The reason why the market fell through the higher low was because the second swing high was created by the banks placing the last of their sell trades into the market, not because people were willing to pay higher prices to purchase currency which is what all the books on the Dow Theory say is the reason why a higher high signals further up-movement in the market.

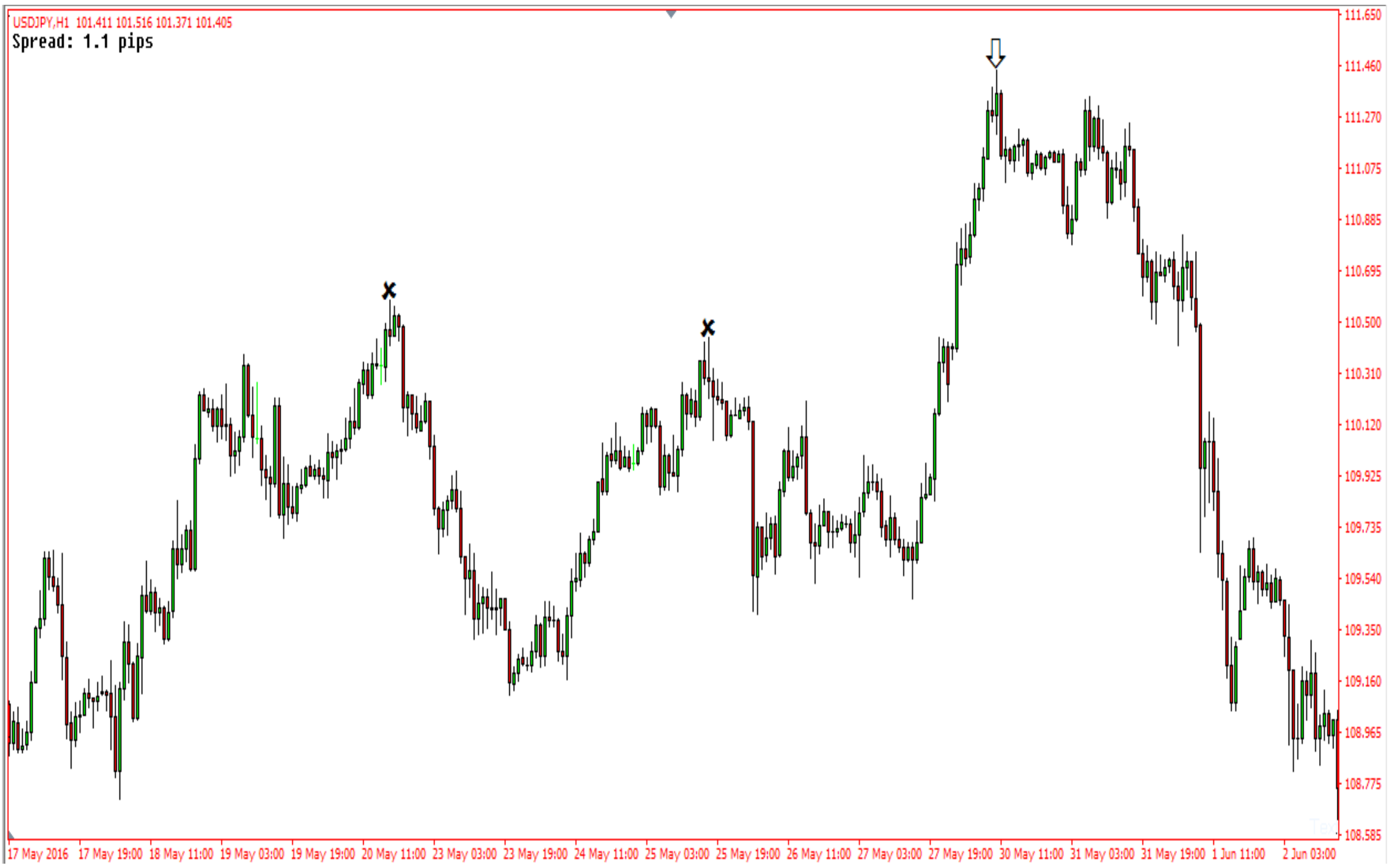
Here's the image we've just looked at only I've removed the tags showing the swing lows and highs and instead marked all of the points where the banks could have potentially got sell trades placed using X's.

You can clearly see from the image how all the swing highs are found really close together. The distance from the lowest swing high where the banks could have placed some of their sell trades to the highest swing high is only 28 pips, this is an incredibly small range when you consider the fact the banks are placing sell trades which probably run into the tens of millions of Dollars.

This image just goes to show how the higher highs formed not because people are willing to pay higher prices for AUD/USD, but because the bank traders were getting sell trades placed into the market. Why they didn't signal a change of trend was because the Dow Theory fails to take into account the method the banks use to get their trades placed.

Now in order for us to determine if a false higher high or lower low has formed in the market, all we need to do is see how far away the new high or low is from the previous high or low.

The reason we do this is because we know if the banks are getting trades placed they will want to get them placed at prices which are really close together. They want the distance between the prices at which their trades are being placed to be as small as possible, using this knowledge means we can determine if a swing high or low is false or not simply based on how far it has managed to breach the previous high or low.



If you look at the image on the previous page you can see I've marked three swing highs, two with X's and one with an arrow. The distance between the lowest high marked with an X and the high marked with an arrow is just over 100pips.

100pips is far to big a distance for all three highs to have been created by the banks placing sell trades. It's much more reasonable to assume the two highs marked with X's were created by the bank traders taking profits and the high marked with the arrow formed because of them placing sell trades.

I've done a little bit of testing on how far the market should move past the highs or lows before you consider them to have formed due to the bank traders placing trades to make the market reverse.

Here's what I found.........

EUR/USD – 1 hour chart = 35pips past the previous high or low

AUD/USD – 1 hour chart = 40pips past previous high or low

USD/JPY – 1 hour chart = 50pips past the previous high or low

If you see the market break a swing low or high by more pips than what I've said above, it's likely to be because the banks have not got any more trades left to place into the market.

Something you'll need to remember about these pip distances, is they're based on the current level of volatility in the market. Over time the distances will change as the volatility in the market increases and decreases.

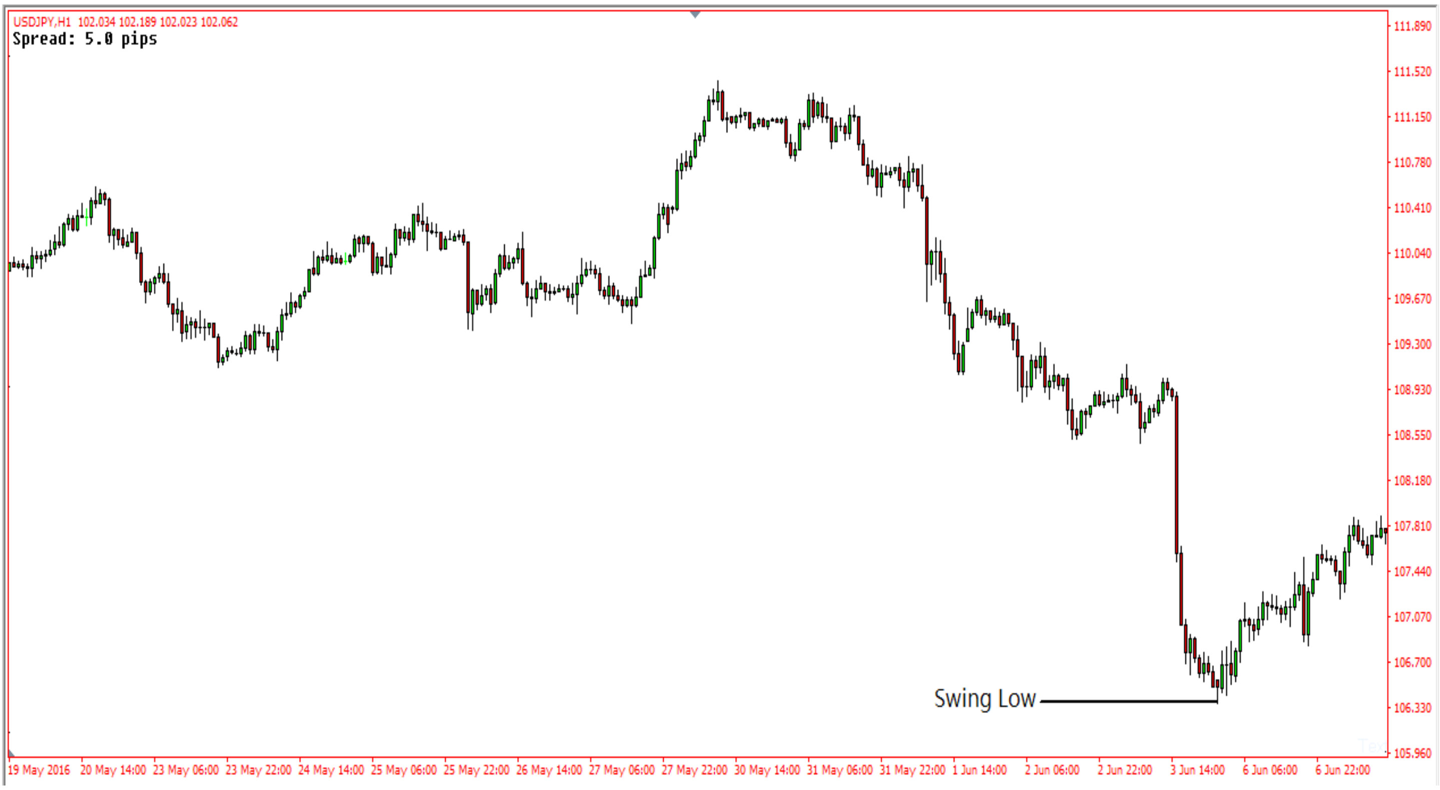
When a change in volatility occurs you'll need to go back and find out the maximum distance the market has managed to move past the swing highs and lows, you can also use this to figure out which distances you should be using for the highs and lows on the other time-frames.

I'll show you how to do this yourself in a later article or book, for now the distances listed above will do you fine for the current level of volatility in the market.

<u>Using The New Understanding In Your Trading</u>

Now we've come to the final chapter of the book. So far I've shown you what causes swing lows and swing highs to form along with the reason why the market will sometimes make a new swing high or low and fail to move in the direction it's supposed to.

What I want to do now is go through a couple of normal scenarios you could easily come across when trading and show you how you could have used your new knowledge of swing lows and swing highs to better understand what was actually taking place in the market.



We'll begin by taking a look at this down-move on USD/JPY.

As you can see the price of USD/JPY was falling as evidenced by the fact the market had made consecutive lower lows and lower highs. Now lets just imagine for a minute that you were the one who was trading USD/JPY at the time this image was taken.

You have just seen the market make a new swing low which is lower than the previous swing low therefore you know the momentum is currently to the downside.

What you wouldn't know at this point, is whether the swing low has formed because of the bank traders placing buy trades to make the market reverse or because the banks traders are taking profits off sell trades placed earlier on in the move down.

It's far more likely to be the latter because big reversals don't tend to occur very often in the market. Even so we cannot rule out the possibility the low may have formed due to the bank traders placing buy trades because if it has, there is the potential for us to make a lot of money from the resulting reversal.

Once the swing low has been made we can see the market begins to retrace into the previous down-swing. Eventually the retracement comes to an end and the market starts to fall leaving a major swing high in it's wake.

Just like the swing low this swing high has been created due to the bank traders either taking profits off long trades which we know they might have placed at the swing low or from placing sell trades to cause a continuation lower.

Again at this point we wouldn't know, but the important thing is to keep an eye on any move up back towards this swing high because if it has been created by the bank traders placing sell trades we know there is a strong possibility they might have not been able to get all of their sell trades placed, which means another move up is likely as they need to generate buy orders to place their remaining sell trades.

Eventually the market has fallen to the point where it has broken through the previous swing low. Because this new low has only managed to breach the prior low by only a few pips, it means the swing low might still have been created by the bank traders getting buy trades placed to make the market reverse.

Had this new swing low broken the old swing low by more than 50pips, it would have confirmed the low had been created because of the bank traders taking profits off sell trades rather than them placing buy trades as they wouldn't get trades placed at prices which were so far away from each other.

When the price begins to rise again your focus would be on whether the market is going to break past the swing high. We know this high has formed due to the banks either placing sell trades or taking profits off buy trades which may or may not have been placed at the two swing lows.

A break of more than 50pips would tell us the swing high has been created from the bank traders taking profits off buy trades which means the two swing lows must have been created because of the banks placing buy trades to make the market reverse.

The market doesn't end up breaking the swing high and instead starts to fall until it has reached the halfway point of the down-swing. Now the focus would be on if the market is going to break though the swing low that was created after the swing high had formed.

We know both of these swing lows may have formed due to the bank traders placing buy trades in order to make the market reverse, if this is indeed the case they will not allow the market to break more than 50pips past the first swing low as this is the first place where the banks could have potentially got some of their buy trades placed into the market.

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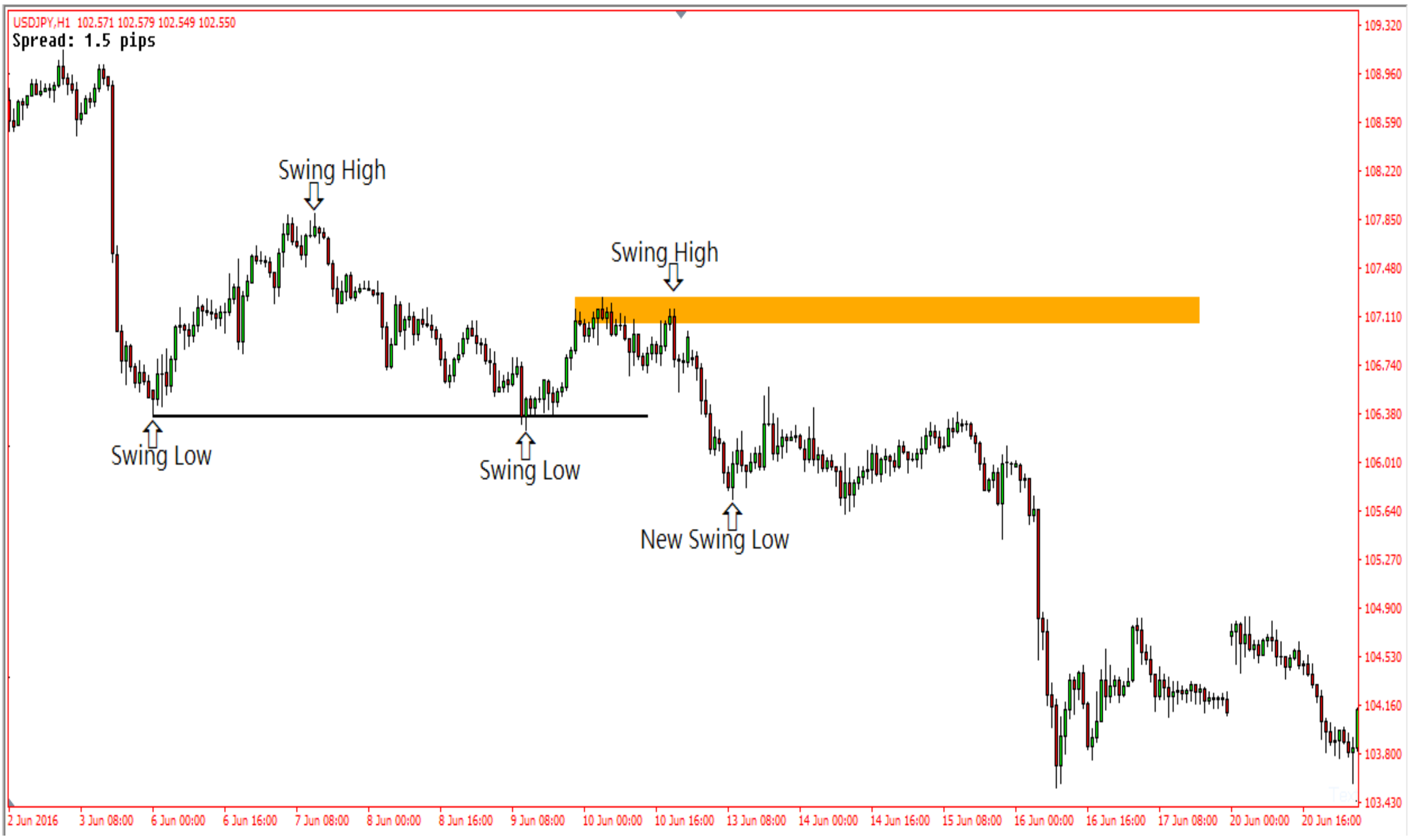


The market does in fact manage to break through the swing low and it does so by more than 50pips which tells us that it's extremely unlikely the two swing lows have formed because of the bank traders placing buy trades to make the market reverse.

Now the break of the swing low means we also have a new swing high in the market. This swing high is our new point of reference for understanding which direction the price is likely to move in next. We know the high has formed because of bank traders placing sell trades as it was the drop from this high which caused the market to break through the swing low.

If the market is able to return to the area close to this swing high it would be a good idea to monitor the price action for entries short as we know the high was created by the bank traders placing sell trades. Some of these sell trades may not have been placed due to the fact not enough buy orders were coming into the market, this means the banks will have to make the price move back up to the swing highs in order to generate more buy orders they can use to get any remaining sell trades placed.

Additionally if the market is able to break through this swing high we know there is a high chance a reversal is taking place as the break would tell us the sell trades the banks placed which caused the swing high to form have now been closed.

The new swing low which is created when the price stops falling is also a point of interest because like the other swing lows, it might have been created by the bank traders taking profits or placing trades.

In this instance the low was again created by the bank traders taking profits off sell trades placed earlier on in the move down. An easy way to tell was by seeing how small a distance the market was able to retrace when the price stopped falling and began moving higher.

If you look at the two swing lows seen prior to the new swing low you can see they both caused the market to retrace a much larger distance than the retracement created by the new swing low. The fact the market is only able to retrace a small distance means it's highly unlikely the low has been created because of the bank traders placing trades to make the market reverse.

This is because the banks need to have a lot of buy or sell orders coming into the market when they are getting trades placed to make the market reverse. The amount of buy or sell orders that will enter the market is dependant on what the traders in the market believe about the future price direction.

When the market starts to retrace after the first swing low seen on the far left of the chart has formed, people begin to enter long trades because they naturally think the retracement is the start of a reversal. As the price rises higher and higher, more and more traders begin to enter long trades because it increases their belief that a reversal is in fact taking place.

Once the price starts to drop, all the traders who went long during the retracement begin to close their trades at a loss, this puts sell orders into the market that causes the price to drop at an accelerated rate and makes additional traders also close their long trades at a loss whilst also making trend traders enter short trades of their own because they feel like the down-move is a continuation of the overall downtrend.

These sell orders are what the bank traders would have used to get buy trades placed if they wanted to make the market reverse. Now the reason why there were so many of these sell orders coming into the market was because of how many traders placed buy trades during the time the market was retracing.

If only a small amount of traders placed long trades, such is the case with the retracement which is really small, there will not be many sell orders coming into the market once the retracement ends because there won't be enough long traders closing losing trades, this means there will not be many sell orders coming into the market which the banks can use to get any of their own trades placed.

The new swing low that forms in our example causes a retracement so small that only a tiny number of traders will have believed the market was reversing. This means that when the retracement ends and the price begins to fall, there are not enough sell orders coming into the market for the banks to get any buy trades placed to make the price reverse.

Now I'm going to give you an example of how this new understanding of swing lows and swing highs could have been used to help determine if a reversal was taking place in the market

Here's a reversal which occurred on the 1 hour chart of USD/JPY

This reversal was caused by the bank traders operating on the higher time-frames taking profits off large sell positions which they had placed at the some point previously during the downtrend.

Now even though the reversal was caused by the bank traders taking profits, there would have still been a large number of bank traders on the lower time-frames getting buy trades placed to make money from the swing higher.

This means even though the reversal wasn't necessarily caused by the banks placing buy trades, we can still analyse it as if it was because of the fact there were still lots of bank traders on the lower time-frames getting buy trades placed at the same points where the other bank traders would have been taking profits.

Okay so to start we had the market making a down-swing in the direction of the trend. Eventually the price has fallen to the point where the banks want to take some profits off the sell trades they placed earlier on in the down-trend.

When they start to take profits the sell orders coming into the market from the retail traders going short are consumed, and the price begins to move up which creates the swing low I've marked in the image. At this point we know the swing low has formed because of the banks either taking profits off sell trades or placing buy trades to make the market reverse.

To find out which one it is we need to see the market break through either the swing low or the swing high. The swing high was created when the banks placed sell trades to make the market fall lower, a break above here would tell us that whatever sell trades the banks had placed have now been closed.

As what we suspected to be profit taking continues, the market rises until it has broken through the swing high that we know formed because of the bank traders placing sell trades.

At this point we would strongly suspect a reversal is taking place because we know whatever sell trades the banks placed to make the market fall from the swing high must have now been closed.

Even though we have a strong suspicion the market is reversing we can never be 100% sure as it's possible for anything to happen in the market at any time. Because of this, it's always best if you wait for more price action to form before coming to the conclusion the market is in fact reversing as it will allow you to get a better grasp on whether a reversal is actually taking place.

If you have read my book on how the banks operate in the forex market you'll know that when the banks are getting trades placed in order to make the market reverse, they'll never have enough buy or sell orders available to get all of their trades placed at the price they want. This means they have to make the market move up or down to get other people to place buy or sell trades just so they are able to get all of their own trades placed.

This is something you need to be aware of if you suspect a reversal to be taking place in the market.

In our example we have a swing low which we believe has been created by the banks placing buy trades to make the market reverse. We know from our understanding of how the banks get their trades placed that they were probably unable to get all of their buy trades placed at this swing low due to the fact not enough sell orders were coming into the market at that time.

This means there's a really high chance we'll see another swing low form before the market reverses and starts to move higher.

It's not long after the second swing high has formed that we see the market drop and subsequently rise up, creating a new swing low and giving us more evidence the market is in the process of reversing.

When the market started to fall after the new swing high was made our attention would have been on the swing low seen at the bottom of the image. A break below this swing by more than 50pips would indicate the banks have not been getting buy trades placed to make the market reverse and have instead placed sell trades at the swing high in order to make money from a continuation of the downtrend.

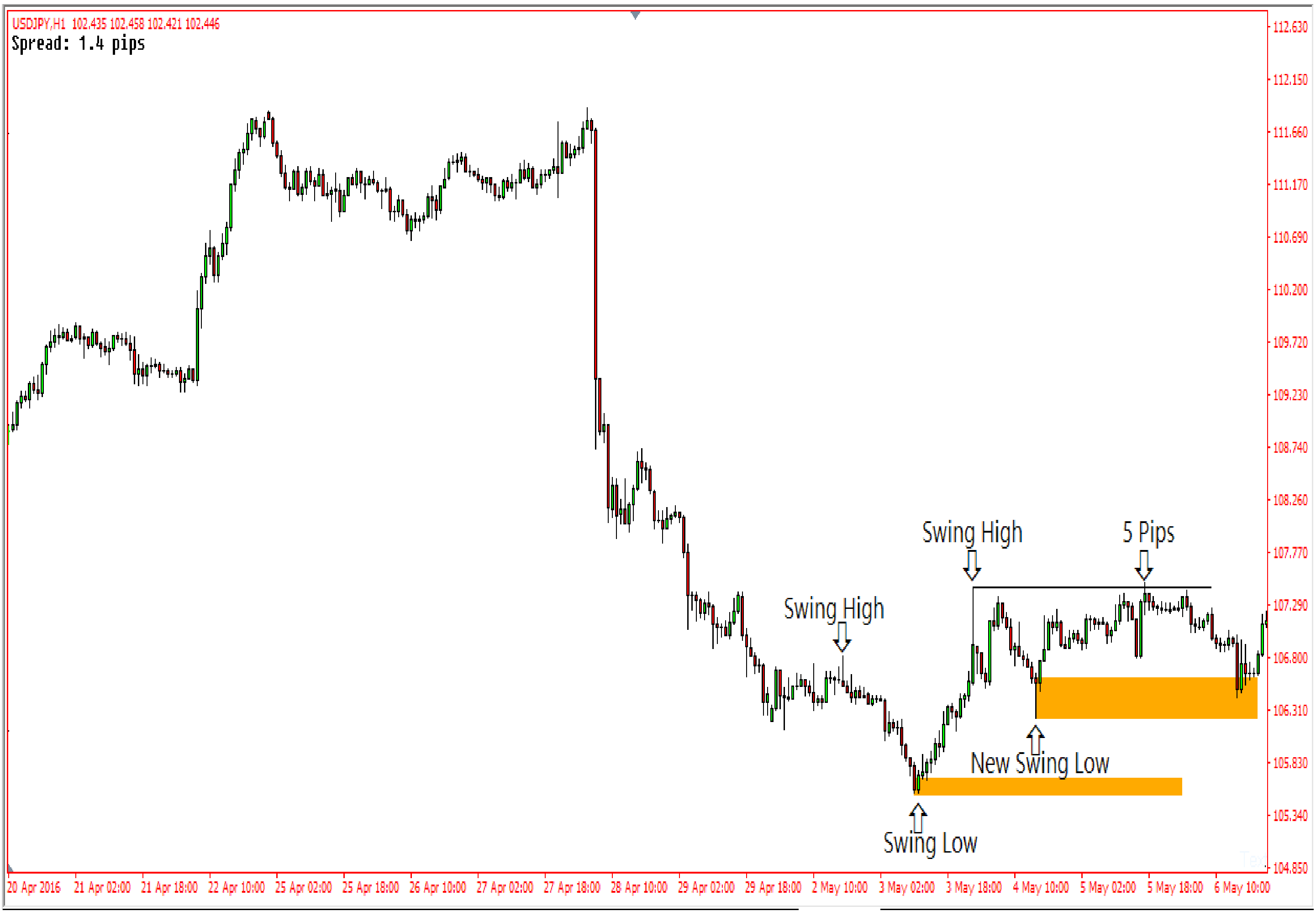
Of course the market doesn't manage to reach the lower swing low and actually ends up reversing around the halfway point of the up-swing, creating the new swing low I've marked in the image.

This new swing low is now our main point of interest. If this low has been created by the bank traders placing buy trades like we suspect the other low has, we know the market shouldn't fall more than 50pips below it.

The swing high on the other hand is also important as we don't know if it has formed because of the banks placing sell trades to make money from a continuation lower, or from the bank traders taking profits off the buy trades we suspect they have placed at the swing low seen at the bottom of the image.

Overall the evidence points to it being created by the bank traders taking profits off long trades.

This is because the previous swing high, which this swing high broke, was the last point where the banks came into the market and placed sell trades. Since the market broke this point by more than 50pips, it means it's incredibly likely the sell trades which the banks had placed here have been closed.

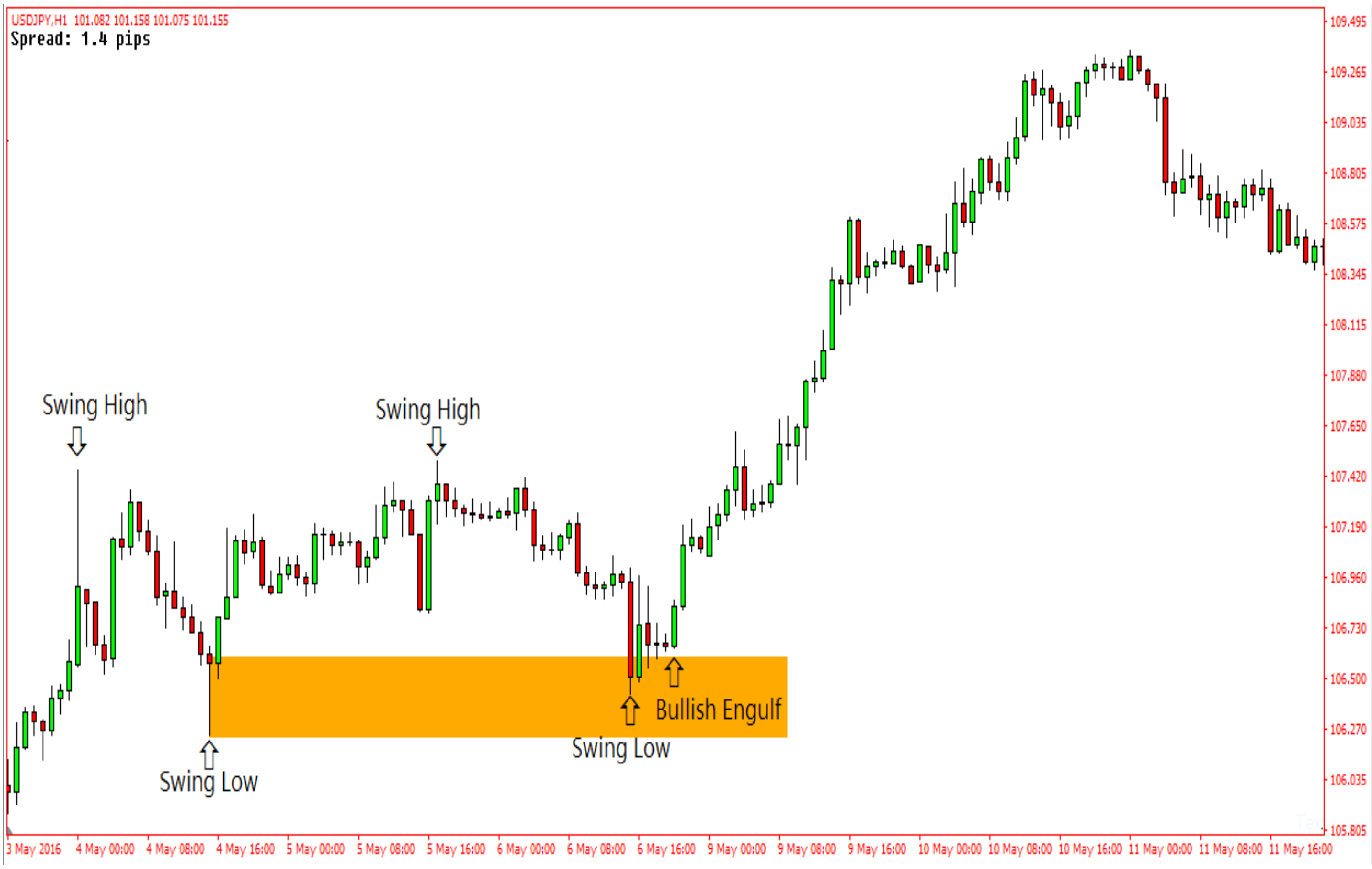


The market moves up and breaks the swing high by 5pips before falling. Now we'd be watching the swing low to see if it gets broken by the move down or if the banks come into the market and place more buy trades.

Important Note:

When you suspect a reversal is taking place in the market you should mark an area around each swing you believe has been created by the bank traders placing trades as these are the points where they are most likely to place more trades if a reversal is in fact taking place.

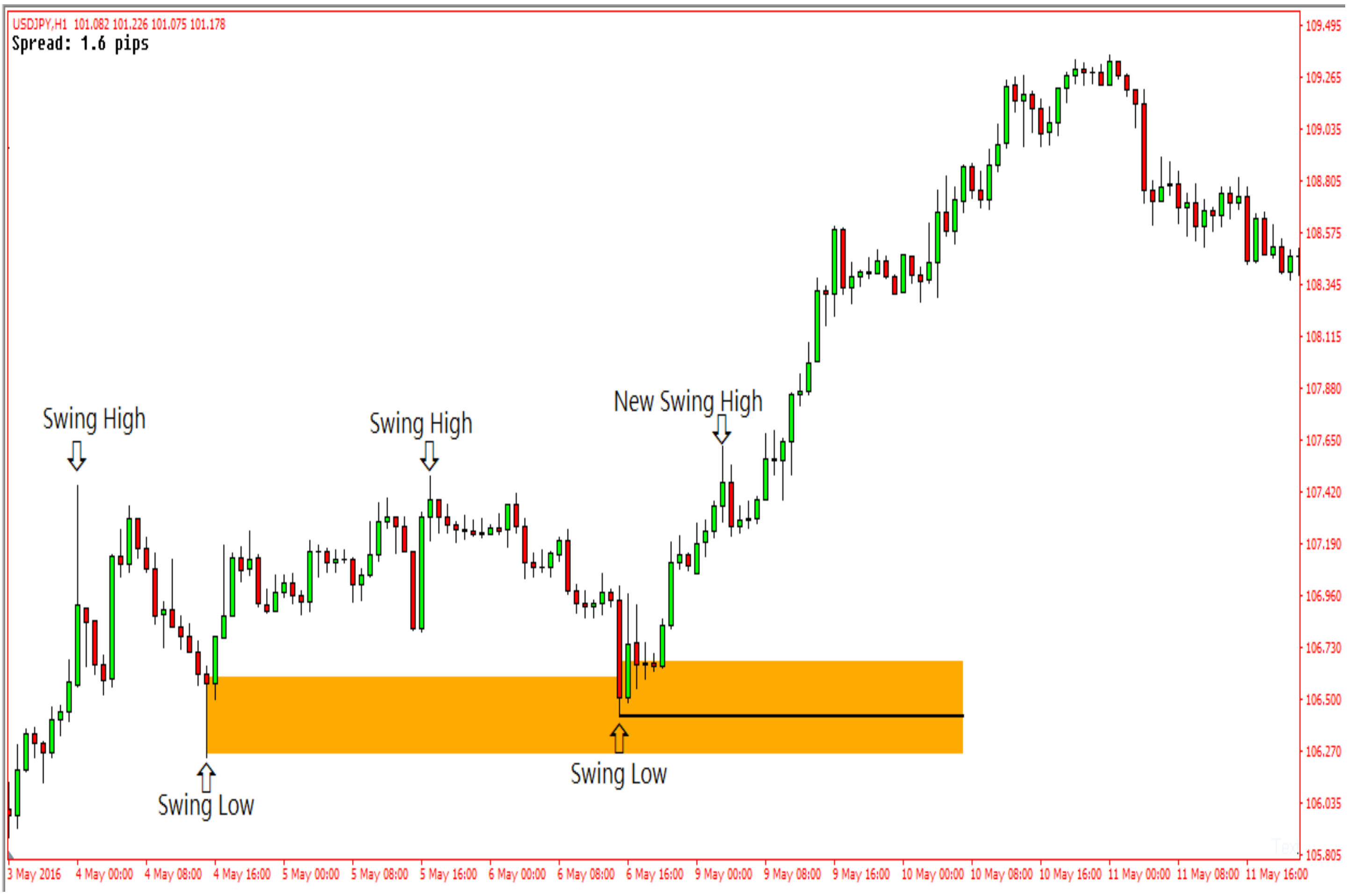
The price falls into the area drawn from the swing low we believe has been created by the bank traders placing buy trades. Here you would be waiting for the market to produce some kind of confirmation that it's going to start moving higher out of the area.



We can see that 4 hours after falling into the area a bullish engulfing candle appears and causes the market to start moving higher. This engulf could have been used as a signal to get long but it was also possible to place a long trade any time after the engulf had formed so long as you had put your stop loss below the swing low.

Once we are in the trade and the price is climbing higher, we need to look to see if the market is able to break through the swing highs as there is still a small chance these swing highs have formed because of the bank traders placing sell trades.

Also we need to mark an area around the new swing low that formed when the market moved out of the area drawn from the previous swing low, as this is another place we know the banks have likely placed buy trades.



Here you can see how I've separated the new area from the previous area using a black line.

If the market fails to break through the swing highs and instead starts to drop, this area would be our next point of focus as it's the most recent place we know of where the banks might have got buy trades placed.

The market does manage to break the swing high but this does not mean the three swing highs have formed due to the bank traders taking profits off long trades. This is because the new swing high terminates only 17pips above the first swing high seen at the far left of the image.

In order for the swing highs to be confirmed as not being created by the bank traders taking profits, we would need to see the new swing high break the first swing high seen at the far left of the image by more than 50pips.

Once the swing high had been broken we see a bearish engulfing candle form.

This engulf only manages to cause a small drop to take place after which the market begins to move higher again past the swing high. The first swing high is then broken by more than 50pips which confirms the three swing lows were in fact created by the bank traders placing long trades to make the market reverse and the swing highs formed due to the banks taking profits off these long trades in order to make the price fall so they could get more of their buy trades placed into the market.

Summary

Swing highs and swing lows are never really seen as being important or interesting by traders but I hope it's clear from the book how a lot of really important information can be gained by understanding what has caused them to form in the market.

I know it has probably been difficult for some people to follow how the new understanding of swing highs and lows should be used in your trading but I think over time it should become easier as it is basically a mechanical system of determining what is going on in the market.

I've made a small summary below of what I believe to be the most important points I want you to take away from this book.

- All Swing high and swing lows form because of the bank traders either taking profits off their trades or placing trades to make the trend continue or reverse.

- The importance of a swing high or low can be determined by identifying the swings that mark a clear change in market structure. If the market was falling but then turned and started to move in the opposite direction the swing low created by the turn is more important than any swing lows that forms during the move higher created by the turn.

- The reason why a swing low or high has formed can be determined by looking at how far the market has managed to move past the previous high or low.