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Trading The Euro: Box It, Squeeze It, Love It, Leave It

by: *John Carter*

Think inside the box when trading currency pairs, and identify boxes on currency charts to create better trading setups.

[Editor's note: Here's a very detailed look at how Carter views the euro market and how he has taken advantage of it via several setups. Our readers seem to appreciate Carter's inclusion of what some might feel are minute points, but we figure that this specificity can mean the difference between a good trade and a bad one.]

Trading is the most deceptive profession in the world. A person cannot walk into an airport, jump into a 747, and take off down the runway without any prior training. Yet people routinely will open an account and start trading without any guidance whatsoever.

For me, the biggest difference in my trading occurred when I learned to ignore my brain and just focus on a handful of good setups. Once I learned the setups, the next challenge was to have the discipline to follow them the same way, each and every time. No thinking, no hemming, no hawing. I did this by recording my trading activity and grading myself on how well I executed each setup instead of using how much money I was making or losing as a gauge. Whereas focusing on the profits and losses automatically encourages the bad habits that plague many traders, a setup-based approach encourages habits that can push a trader into the realm of consistent profitability.

Tried-and-True Favorites

Which setups do I like? Although I spend a large amount of my trading day focused on the E-mini S&Ps and the mini-sized Dow, there are plenty of times when these indexes are dead in the water. On days when the indexes are trading in a range that is narrower than Paris Hilton's outlook on life, I look to the currencies for my next setup. Two favorite setups in the currencies are called the "box play" and "squeeze play." I execute these primarily on the EUR/USD (euro versus the U.S. dollar), but they work on all currency pairs.

I like to focus part of my trading day on scalp plays, jumping in and out of the market with a little piece here and a little piece there.

However, there's also purpose to focusing part of my time on catching potentially bigger intraday moves as well as multiday and multiweek moves. This means focusing on scalp plays in one account and using a second account for swing plays.

The box play and squeeze play are diverse setups that can be used for both scalp plays and swing trades. For intraday trades, I use five- and 15-minute charts, and for swing trades, the 60-minute and daily charts.

Box Plays: Measuring the Move Before It Occurs

The one thing traders soon learn about the markets is that they will never move straight up or straight down forever. A market definitely can rip higher for long time, but at some point it will have to rest and consolidate, and sometimes it will even come back down to earth and reverse all of those spectacular gains. Just as runners can only sprint for a limited amount of time before their bodies give out, a market can only move so far before it needs to pause, take a rest and build up its energy reserves for the next major move.

For box plays, look for a market that is taking a rest before its next spurt higher or lower. A trader should see a period of horizontal consolidation with at least two tests of the highs and two tests of the lows. Once a trader gets these two tests, he should look to buy a breakout of the box or sell a breakdown of the box with the target on these trades being the width of the box. (These plays can be done on all timeframes, though my preference for day trading is five- and 15-minute timeframes.)

For swing trades, a trader can look to the 60-minute and daily charts, which can be traded as both swing and intraday plays, with each timeframe independent of itself. In other words, a trader could have a 60-minute box play and a five-minute box play going at the same time, with different parameters and in different directions. Also, because the euro actively trades around the clock, these box plays can be set up at any time. I like to try to get some sleep each night, but on those nights when I get shafted by the wait staff (i.e., I order decaf coffee after dinner but they give me caffeinated, so I end up lying in bed staring at the ceiling), at least I can get up and check if a box play is forming overnight.

The Buy Rules (Sells Are Reversed)

1. Set up a 24-hour chart so the overnight activity can be accounted for in this indicator setup.

2. Set up a simple bar chart on the timeframe you want to play without any other indicators or "junk" cluttering up the screen. Search through various time frames to see where box plays are currently setting up.

3. As the market action progresses, take a horizontal line and start marking highs and lows. Adjust this horizontal line a few times as the market action develops. Once you get two tests of one of the lines, you have a potential box play developing.

4. Watch for another test on the opposite side of the box. In this example, assume that the trader does, and now he has two tests of the highs and two tests of the lows. The width of the box is 20 ticks.

5. Once the box is formed, place two orders. Place a buy stop order one tick above the high end of the box. Place a sell stop order one tick below the low of the box. Whichever way the market breaks, the trader is waiting for his order to get filled.

6. The buy stop is hit. Place a limit sell order 20 ticks (the width of the box) away from the entry point. Leave the sell stop in place, as this now becomes the stop loss order on this trade. This represents a risk reward ratio of a little over 1:1.

7. Stay in play until the stop or the target is hit. Do not trail stops.

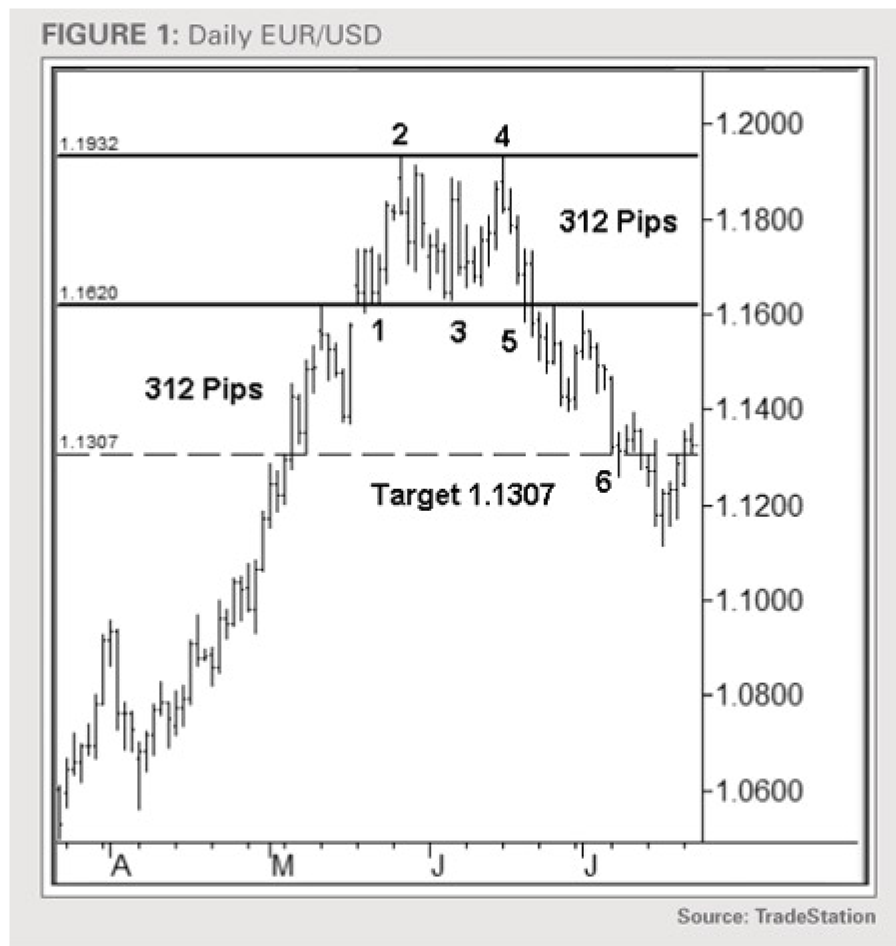


Figure 1 is a daily chart of the EUR/USD. This is an example of a swing trade and a bigger example of the "power of the box." On May 20 and May 21, lows form at 1.1620. On May 27, the market loses steam from its vault higher and sells off, forming the highs of the box 312 pips later (a little over three cents). On June 4 and

5, the market retests the lows of the box. On June 16, there is a retest of the highs of the box. Once this happens, I place my orders. I use a buy stop at 1.1933 and a sell stop at 1.1619. My sell stop is hit at 1.1619. Because the width of the box is 312 pips, I calculate my target accordingly and place a buy limit order at 1.1307. My stop is my original buy stop order at 1.1933.

The market moves down nicely and then shoots back higher. Anyone using a trailing stop for this trade would have been stopped out for a small gain. The reason I keep my stop wider – and the reason I do not trail it – is because this is a high-probability play, and this setup needs "room to move" in order to work out. My target is hit nearly two weeks later for a gain of 312 pips, or $3,120 per contract.

On August 3, the euro formed a box on the 15-minute chart (see Figure 2). The first high was marked at point 1. A few hours later, a potential low for the box forms, and I initially draw a horizontal line at the lows here. The market bounces, and I get a retest of the highs. Then the euro sells off nicely and I get a retest of the lows. Because this low pushed a little lower than the low at point 2, I go ahead and move the horizontal line down to reflect this low.

Once these lines are set up, I place my orders. I use a buy stop at 1.2062 (one pip above the highs) and a sell stop at 1.2042 (one pip below the lows). My sell stop is hit at 1.2042. Because the width of the box is 18 pips, I calculate my target and place a limit buy order at 1.2024. My stop is the original buy stop order at 1.2062. My target is hit, and I'm out for a gain of 18 pips, or $180 per contract. I don't have to remember to cancel my open buy stop because my execution software does it automatically.

Now, if I could just automatically remember to compliment my wife's choice of clothing each and every day, I will be good to go.

In Figure 3, there is a first test of the highs at 1.2347. Once the market sells off from this level, I draw a horizontal line across the high. The market sells off and pushes as low as 1.2323. I start off drawing a line at this level. Later I move this line back up to 1.2331 because the rest of the price support tests were much closer to this level than the "wayward tick." Here there is another test near the highs and another test near the lows. Once the four price tests are complete, I place a buy stop order at 1.2348 and a sell stop order at 1.2330. Although this box isn't perfect, there is no doubt that a nice horizontal channel is in place.

FIGURE 3: 15-minute EUR/USD

Source: TradeStation

The buy stop order is hit. Because the width of the box is 16 pips, I place a sell limit order for my target at 1.2364. My sell stop remains in place as my stop on this play.

My target is hit, and I'm out for 16 pips, a gain of $160 per contract. I also could have used the low of the wayward tick in my calculations, and this would have been a more profitable trade. The bottom line is that when it comes down to a few ticks, it is not a big deal where you place your horizontal line as long as it is crystal clear that a box is in place. As one of my former mentors hammered into me, "Don't be a weenie for a teenie." Now let's take a look at the next setup.

Squeeze Plays: Jumping on the Train Just as It's Leaving the Station

The squeeze play takes advantage of "quiet periods" in the market when the volatility has decreased significantly and the market is building up energy for its next major move higher or lower. These quiet periods are identified when the Bollinger bands narrow in width to the point at which they are trading inside the Keltner channels. This marks a period of reduced volatility and signals that the market is taking a breather and building up steam for its next move.

The trade signal occurs when the Bollinger bands then move back outside the Keltner channels. I use a 12-period momentum oscillator to determine whether to go long or short. If it is above zero when this happens, I go long; if it is below zero, I go short. These are all canned studies that come with most charting packages. For the parameters, I just use the default settings on TradeStation. I also took an extra step and turned all of these into an indicator, and that makes it easier to read on the chart.

The Buy Rules (Sells Are Reversed)

1. Set up a 24-hour chart so the overnight activity can be accounted for in this indicator setup.

2. The "heads up" on this setup is the first black dot (see Figure 4). This is not a trade signal, but a heads up that a trade signal is setting up.

3. The signal on the indicator is the first gray dot after a series of black dots. (This is shown in detail in the charts on this page.)

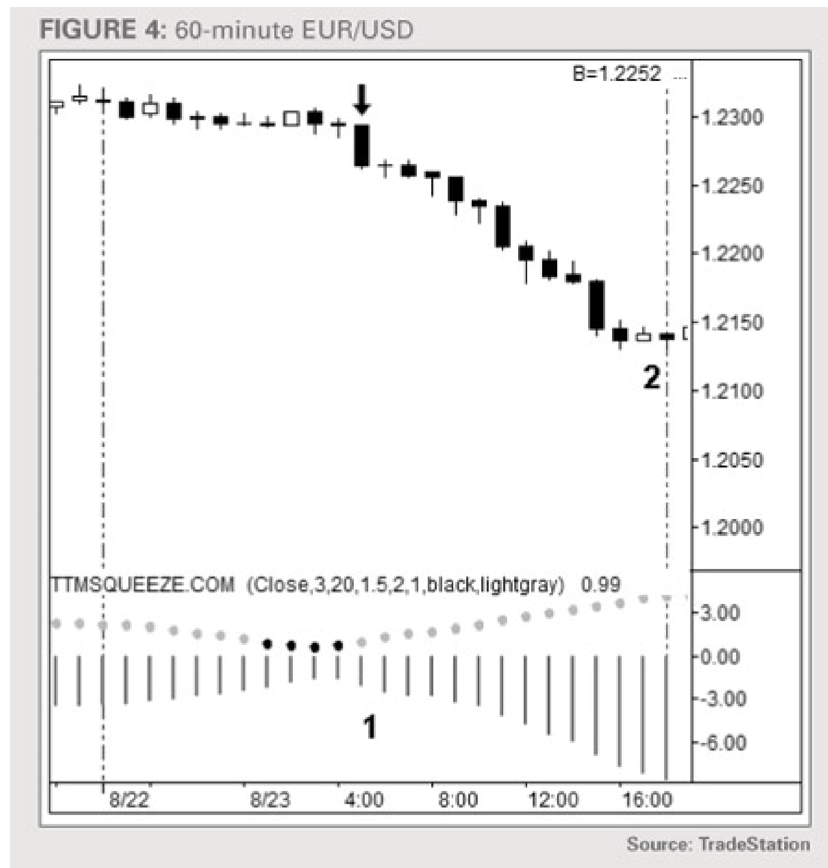
4. Once the first gray dot appears after a series of black dots, go long if the histogram is above zero. Once the signal fires, just place a market order. This is a momentum play, and a trader shouldn't mess around with limit orders that may not get filled. (Remember the whole thing about weenies and teenies?)

5. Base stops on the timeframes you are using. For five-minute charts, use a 20-pip stop. A 15-minute chart gets a 25-pip stop; 60-minute chart a 30-pip stop; and a daily chart a 50-pip stop. One pip equals 1/100 of a cent and equates to $10 on a regular-sized contract and $1.00 on the minis.

6. Base target purely on the momentum of the trade. Once the momentum signal starts to weaken (rolls over), get out of the trade at the market.

7. Don't trail stops. Treat this position like I treat my marriage—I may want to try to change something about the trade, but in the end I've learned it's best to just leave it alone.

On August 23 (Figure 4), I awoke to see that the euro had just fired off a squeeze. This is marked by the first gray dot after the series of three black dots. Because the histogram is below zero, I short at the market, getting filled at 1.2252. I place a 30-pip stop at 1.2282. The market sells off considerably, and the momentum on the histogram never lets up. I stay in the trade all day, exiting at 4:00 p.m. (Eastern time) when the momentum begins to slow. I exit at the market and am filled at 1.2146 for a gain of 106 pips — $1 ,060 per contract.



In Figure 5, a five-minute chart of the euro, we go into "black-dot territory" a little before 10:00 a.m. (Eastern time); 25 minutes later, the first gray dot appears (point A). The histogram is above zero so I go long at the market and am filled at 1.2054. I place a stop at 1.2034. The market rallies steadily for the next 90 minutes and starts to lose momentum just before 12:00 p.m. (point B). I exit at the market and am filled at 1.2153 for a gain of 119 pips, or $1,190 per contract.

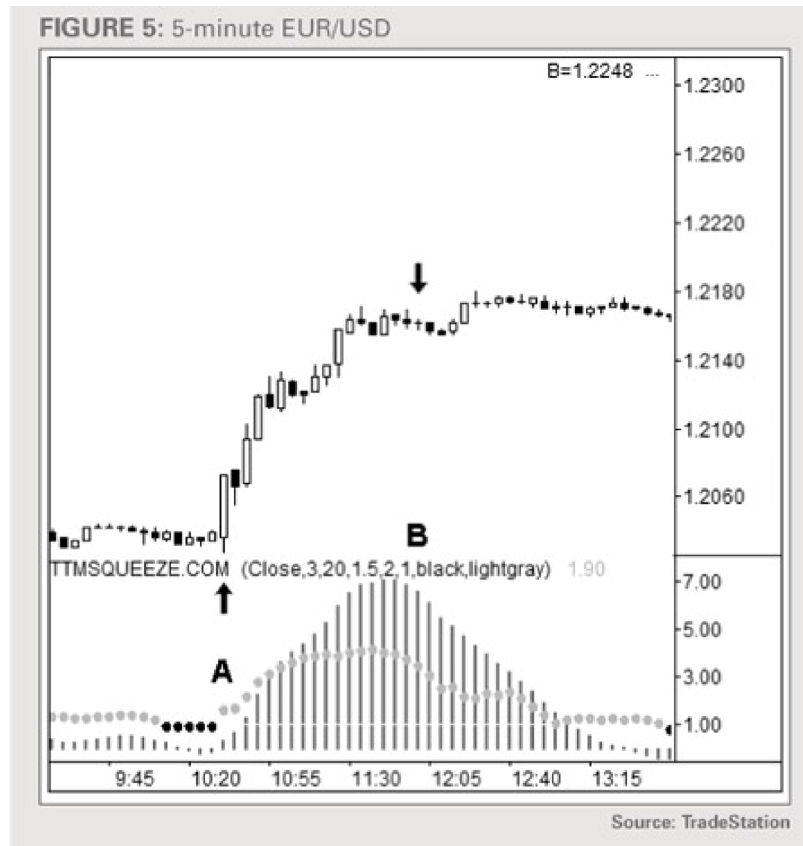


FIGURE 5: 5-minute EUR/USD

Source: TradeStation

When It's Quiet...

Box plays and squeeze plays show when the markets go into quiet mode. The only reason markets go into quiet mode is because they are building up energy for their next major move. A trader should be on alert for this move, and of course, also for the direction of the move. Both of these setups can help traders take advantage of ebbs and flows in the market.

In parting, I can't emphasize enough how important it is for traders to find a market that fits their own personality if they hope to be successful. If you find that you are only happy if you are buying breakouts and selling breakdowns, then the euro is probably your market of choice. This market breaks and trends well, while the E-mini S&Ps tend to suck in traders with false breakouts and breakdowns. In other words, if you are buying breakouts in the S&Ps and getting killed, then give the euro a try.