

Pin bars: introductory tutorial

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Introduction

Jim (a.k.a. James16 at the Forexfactory.com forums) has taught many forexfactory.com members how to play pin bars. This instruction has been through demonstration over dozens of posts. This makes it difficult for a learner to quickly pick up key concepts and terminology. This tutorial on how to play the pin bars has been designed as a good first lesson and introduction to pin bars. It provides an explanation of the pin bars and familiarises the reader with terms used by James16 in the examples (such as 'eyes' for the pin bar). The Advanced Tutorial covers some higher-risk setups that may appeal to some traders. For further instruction please see the James16 Chart Thread at Forexfactory.com or the James16 private forum (www.james16group.com).

Topics covered in this tutorial:

Introduction to pin bars – what the pin bar looks like

Playing the pin bar – how to enter a trade based on the pin bar

Trading the pin and managing risk – trading the pin bar sensibly

Finding the pin bars – a look at pin bars (and bars that are NOT pin bars) over a one month period

Some final thoughts – some closing remarks

Terms used in this tutorial:

Eyes – the extreme values that the price reaches on the bar before and after the pin bar. See Figure 1 for a visual explanation.

Fib level – Fibonacci retracement level of the previous move. Most charting applications have the ability to draw these automatically or easily.

MA – moving average.

Nose – The long spike of price in the pin bar. See Figure 1 for a visual explanation.

Pin bar – abbreviation of Pinocchio bar, coined by Martin Pring (pring.com). They are also known as 'pins'.

Inside bar – a bar which has a lower high and a higher low than the previous bar (it sits inside the range of the previous bar).

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Introduction to pin bars

This section explains what the pin bar is. Following sections explain how it may be traded. Generally examples are only given for pin bars pointing one way. The same concepts can be applied to pin bars pointing the other way (just reverse the concepts!).

Trading is a probabilities game. There is always risk of loss and the trade going ‘the wrong way’ after the pin bar has formed. All we can expect to do is to tip the odds in our favour. When good pin bars are traded then a trader can tip the odds in their favour. Some trades **will** result in losses; such losses will occur with any trader from time to time. (Even a good pin bar setup may result in a loss!)

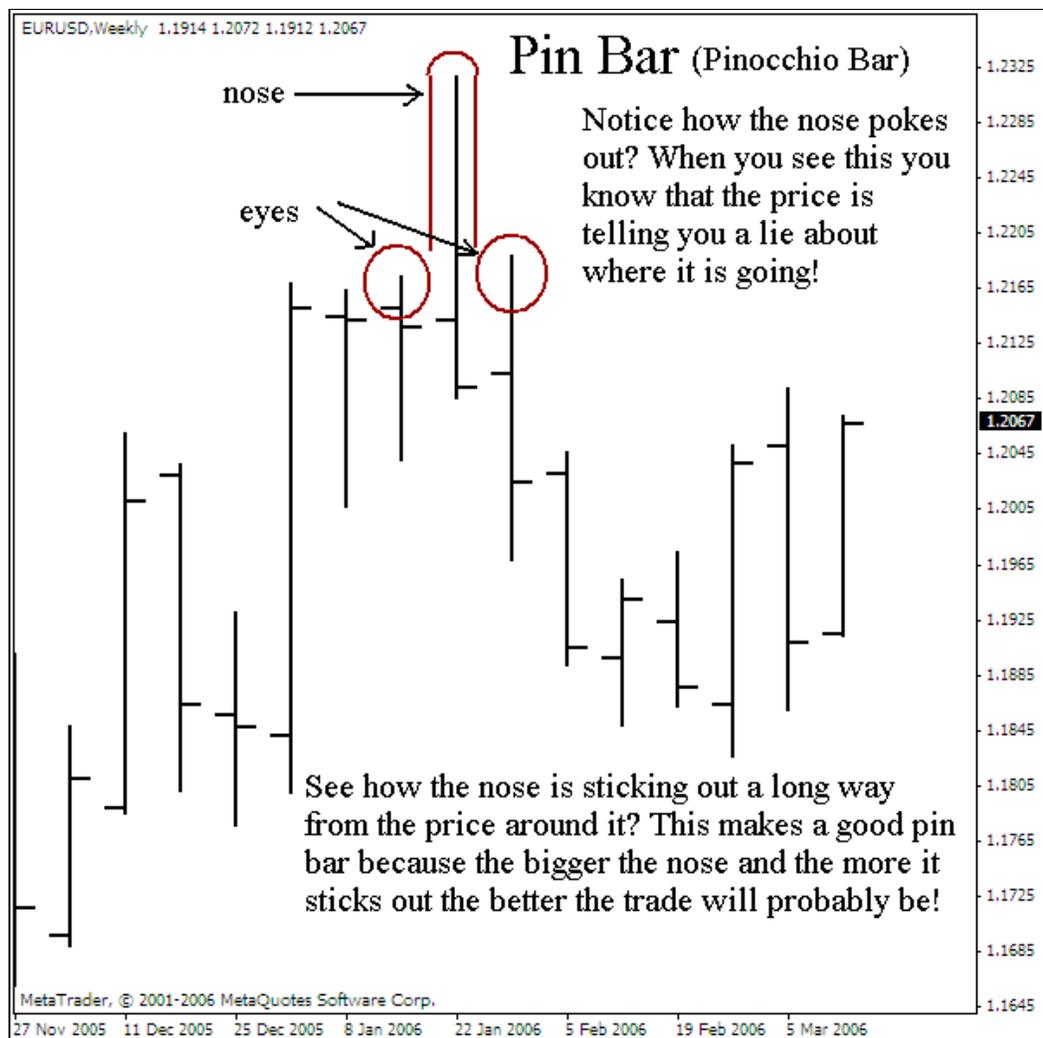


Figure 1. The anatomy of a pin bar

Looking at Figure 1 we can see what a completed pin bar looks like. See that this Pinocchio bar (which is abbreviated to ‘pin bar’) is poking his long nose outwards and is telling you a lie (an untruth) about where the price is going. The name is based on the old European story about the wooden boy, Pinocchio, whose nose grew longer every time he told a lie. The bigger the lie the bigger the nose! For us this means that

we want a nice long nose when we see a pin bar. We trade in the opposite direction to where the nose is pointing (so the pin bar in Figure 1 indicates that traders should be taking short positions while trading EURUSD). The high of the bars on either side of the pin are the 'eyes' for the pin bar. Note that the open and close of the pin must be within the left eye. For a nose pointing up, this means that if the high of the eye is roughly at the 1.2175 level (as shown in Figure 1), then the open and close of the pin bar must be below this level of 1.2175 (as is the case here). If the open/close is outside of this level then it is not a real pin bar (see the Advanced Tutorial for some ideas on how a trader might deal with a bar that looks like a pin bar but fails to meet this requirement).

The pin bar means that the price is going to move in the opposite direction to where the nose is pointing. In Figure 1 the nose is pointing up so the trader should expect prices to move down.

A pin bar must:

- have open/close within the first eye,
- protrude from surrounding prices ('stick out' from surrounding prices); it cannot be an inside bar.

A good pin bar has:

- a long nose (and a long nose relative to the open/close/low),
- a nose protruding a long way from the prices around it (it 'sticks out'),
- the open / close both near one end of the bar.

The pin-bars can be played by themselves as they occur on the charts. One forexfactory.com member did some automated back testing and found that merely playing a pin bar does not provide spectacular results. You need to carefully select the pin bars you want to play. The best pin bars are played as they bounce off either:

- 1) Fibonacci levels (retracements of the previous move)
- 2) Important pivot levels
- 3) Moving averages
- 4) Confluence (several MA or Fib levels in the same general region)
- 5) Swing high / swing low
- 6) Retracement of the current move (must retrace a minimum of 23% fib retracement of the current move), which is a lower probability play.

For the BEST results a trader may play a pin-bar on the swing high (or swing low) or a pin-bar that is bouncing off confluence (of MA and Fib levels). The pin bar is a very reliable setup under these circumstances, indicating that there is a high probability that prices will change direction – which is very tradeable setup!

Shown is a cluster of Fibonacci retracement levels from the big moves down during 2005. Note that the pin bar is bouncing right off these. This means that the pin bar has bounced off an area of confluence!

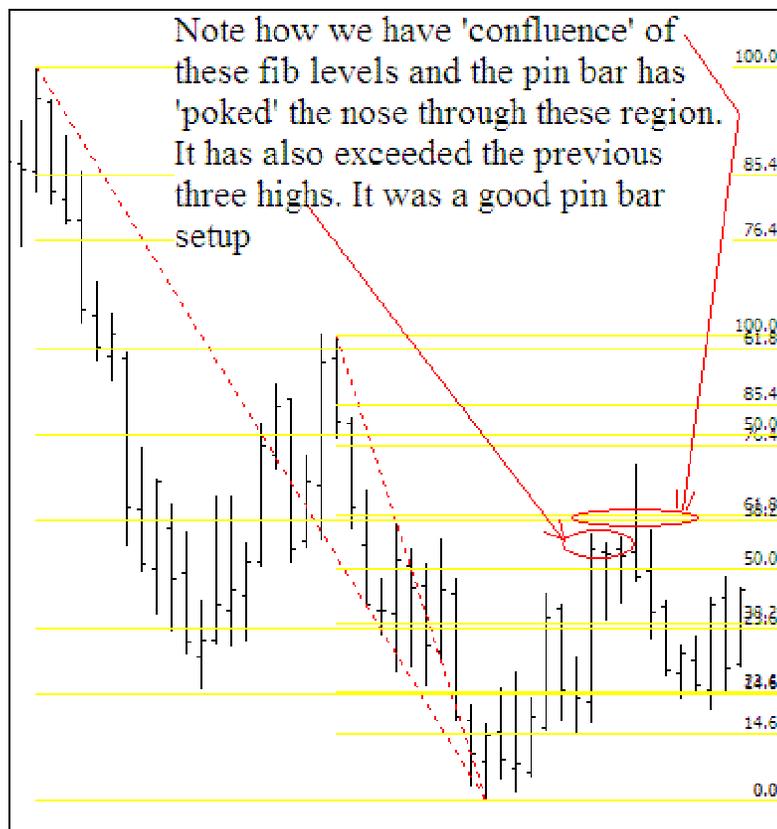


Figure 2. A look at the pin bar and fib retracements of previous moves

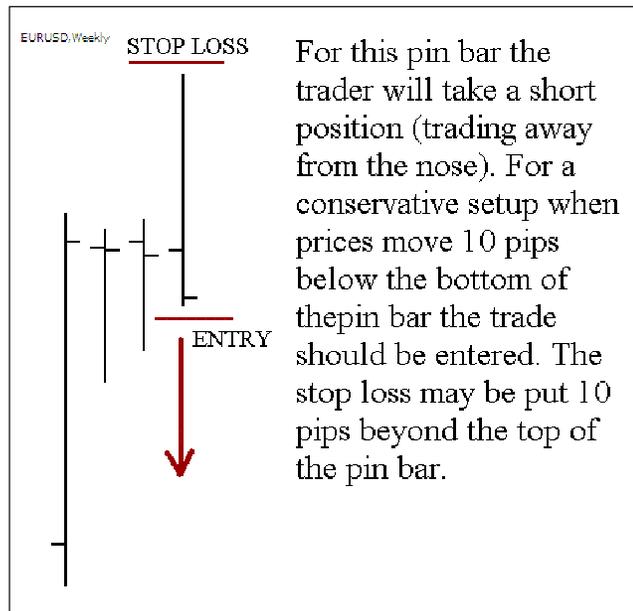
Shown in Figure 2 is a close-up of the pin bar that formed on the EURUSD pair weekly chart. Notice that there is confluence of fib retracement levels from the more recent previous movements down. This pin bar has punched through these, after three previous bars were bouncing off this area. This would have been a good pin bar to catch. The three previous bars failed to move through this area, showing it has significant resistance. The pin bar has moved a long way through it before moving right back down again. The high made by the pin bar is probably the highest price that will be reached for weeks (or months).

Is this a good pin bar formation? The nose of the pin bar pokes out a long way above previous prices. It has made it through some resistance at the confluence of fib levels and bounced off the longer-term fib levels (in Figure 2). The open and close are below the high of the previous bar (the eye). Yes – this is a good pin bar.

Playing the pin bar

This section details how the pin bar can be played. The advanced tutorial provides more details of how a more experienced trader might approach the pin bar.

Traders that are new to pin bars may put a limit/stop order under the bottom of the pin bar. It is placed 10 pips under to account for a false break-out (unlikely to be 10 pips). When this order has been triggered then the trend will probably be heading in the opposite direction of the nose. This approach also means that the trade does not need to be monitored so closely.



For this pin bar the trader will take a short position (trading away from the nose). For a conservative setup when prices move 10 pips below the bottom of the pin bar the trade should be entered. The stop loss may be put 10 pips beyond the top of the pin bar.

One question that traders may want to ask themselves as they contemplate entering a trade is this: “When will I know if the trade has gone against me and this setup is not working?” When you know how to tell whether or not your trade setup has failed and is not going to work you can begin to calculate how much risk you can take. These calculations are performed before placing orders so that the appropriate level of risk (on the basis of account size) may be determined so that an

appropriate position size may be taken.

The conservative approach to placing stops is to place stops 10 pips from the end of the pin-bar/nose (the point where the prices are not going, far from the eyes). This level is acting as resistance now. The stop loss and entry orders are placed 10 pips away from highs and lows because sometimes prices will creep a little bit past these highs or lows which can have a negative impact on the trade setup.

Traders need to discover their own preference for stops and risks based on the pin bar. The Advanced Tutorial gives some more ideas of how to enter and set the stop losses.

Trading the pin and managing risk

This section discusses what to do once the trade has been entered and how to manage the risk during the trade.

So, you're in the trade - congratulations! Unfortunately entering the trade is simpler than exiting it correctly. Very often several traders in a forum will enter a trade based on pin bars yet one trader will make twice as much profit as another trader because of the differences in the way they exited the trade. The recommendations in this section are based on the following four premises:

- 1) Very few good pin bars (swing high/low or bouncing off confluence) will move directly to hit the initial conservative stops that trader has placed, without first giving the trader the chance to take *some* profits (this may happen roughly 10% of the time or less),
- 2) Traders should take the profits as they are offered by the market,
- 3) Traders should NOT let a winner turn into a loser (this point has been reiterated by several experienced traders at the forexfactory.com forums). Hell, you've earned this profit; do not let the market take it back, and,
- 4) There are PLENTY of opportunities to trade pin bars, be patient and take only the best pin bar setups!

In essence is it important to close out part of the position early and learn to shift the stop loss to the break even point quite quickly.

The first thing that a trader should try to do when playing a pin bar is close out the trade incrementally. This means that the trader closes part of their position early, at small profit. The benefits of doing this stem from the fact that it banks some profit (consistent winners are those that bank profit); the corollary of this is it reduces the number of lots that can then hit the stop loss (so it has reduced the remaining risk for the trade). The trader can achieve this objective by splitting the total position into several distinct trades or lots. (Remember that no matter how it is split the total value at risk should not exceed your threshold.) The preferences of how the trade is split up and where the targeted profits are depend on the individual trader. It is best to take some profit initially at 20-30 pips profit (depending on the expected range of prices on the currency pair you're trading and the time-frame you're trading), then take more profit a little further on.

It is always uncertain how far a trade will run. Trades resulting from pin bars might run from one bar before the prices turns back, or they may run for many bars. Lock some profit in and leave a portion (1/2, 1/3 or 1/4) of your trade to run until completion. When you lock in your profit by closing out a portion of your trade early you have banked profit (realised profit as opposed to unrealised profit through having the position un-closed) and your total open position size has decreased, meaning that if there **is** a sharp reversal to your initial stops then the loss has been reduced by a reduced position size **and** already having banked some profit. (If you do not understand this concept then please take a pen and paper and fiddle with some numbers and prove it to yourself.)

After a trader has initially banked some of their profit they will want to consider shifting the position of the stop loss. Exactly how this is performed is up to the trader and will depend upon their own trading style. It is an important part of playing the pins, however, as **successful traders do not want their winning trades to turn into losers!**

“So when I get up [*into a reasonably profitable position*] on a trade the "golden rule" comes into play: never ever let a winner become a loser, for any reason, no matter the scenario ...”
-Vegas.

Once a trader has taken some profit and shifted the stop loss to the break even point they are in a “free trade”. All pressure is now off the trader, no matter what happens they have banked some profit on this trade and made some money. The trade can now run for large profits without the trader worrying about making a loss on the trade.

“Trading is about "free trades". Those of you who don't understand this concept need to stop trading until you do. It doesn't matter what method you use.”
-Vegas.

Because we cannot know what will happen to the price in the future it is necessary that some profit be taken early. Selecting the **BEST** pin bars and exercising patience will mean that a trader can cherry-pick the pin bars with the highest chance of success. Around 70% of these will be quite profitable. If 10% just reverse to hit the initial stops, then these losses are more than made up for by the profits taken early on many other trades. Around 20% of good pin bar trades will be good winners where the price runs and the final portion of the trade will be chasing big pips and bigger profits.

Can a trader prevent losses that may occur while you trade the pins? No. This is why it is wise to use the initial stops at the start of the trade. This means that the trader has defined the circumstances under which they know their trade setup has failed and they do not want to lose more money. Doing this indicates that the trader has accepted that there is some risk of the trade failing. These losses are the cost of doing business in the forex market – traders need to accept them.

Finding the pin bars

The purpose of this section is to give several examples of what a pin bar looks like. Take a look at Figure 5 and the bars that have been numbered (either below or above the bar in question). The chart shows the daily charts for the GBPUSD pair for a period from the 20th January 2006 to the 23rd February 2006. Look at the image and decide whether the numbered bars are good pin bars to trade, based on how they look and where they are. Decide which of these bars, if any, you would trade. See if your comments match those made below.

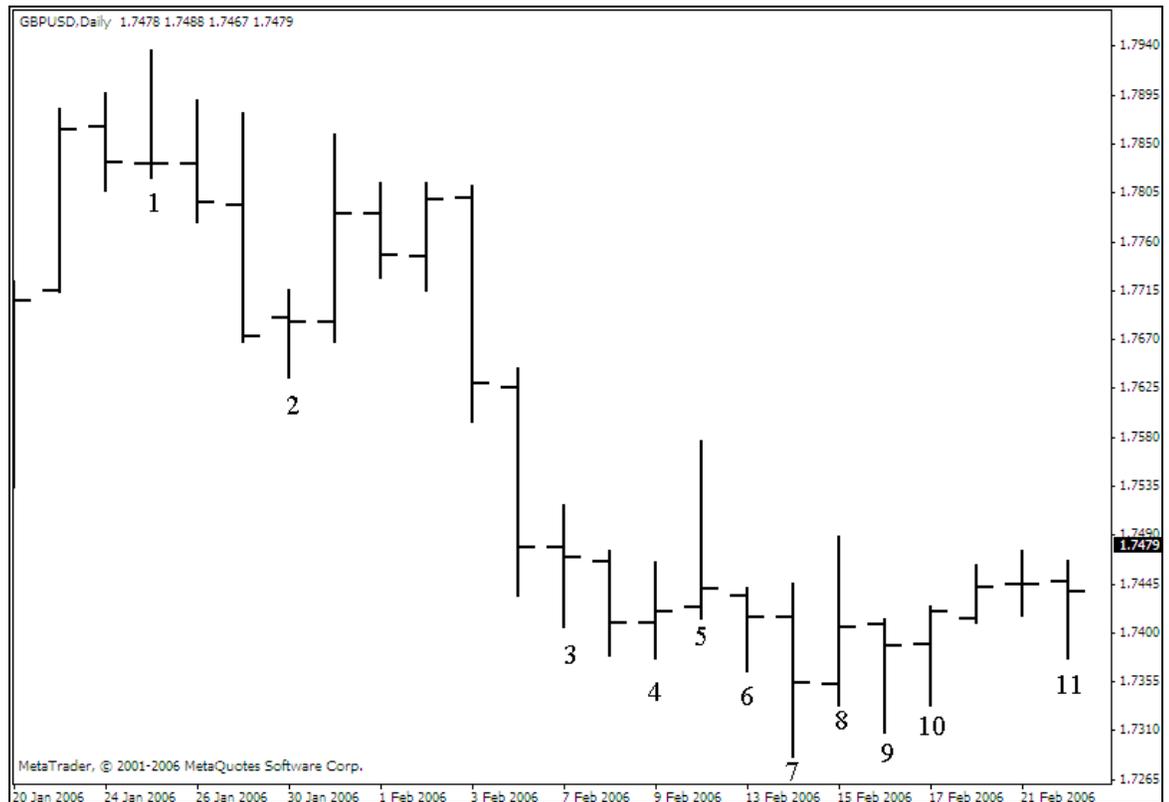


Figure 3. Pin identification

1. This bar has good form. The open and close are nearly equal and they are very close to one side of the bar (in this case, the bottom) and are lower than the previous eye. But the nose is not very long and it doesn't protrude much from the prices of the previous eye and the bar before it.
2. The open and close are nearly equal and are quite close to one side of the bar (in this case, the high) and are also higher than the previous eye. The nose is not very long and it does not protrude much from the previous eye.
3. The open and close for this bar are nearly the same but they are getting quite close to the middle of the bar – it is almost a neutral bar. It is good that the open and close are above the previous eye. The nose is not very long because of this. (Note that if you played this pin on a break of the pin bar (taking a long position) there would have been no trade as prices went down on the next bar.)
4. The open and close are nearly the same but they are also right in the middle of the bar. It is also an inside bar (or very close to it) where the bar

makes a lower high and a higher low than the previous bar – so prices are not protruding.

5. The open and close are near the same price and are right near one end of the bar and are lower than the previous eye. The nose is nice and long, which is good, and protrudes nicely from previous prices. This would have been a good pin to play on the break and we can see that for the next two bars if we had taken a short position there would have been good opportunity to profit from the setup.
6. For this bar the open and close are near one end of the bar and are higher than the eye. Note that the nose doesn't stick out much beyond the low of the bar that has been numbered 4, so prices have not protruded much. If we look at the next bar we see that prices only go 5 pips above the high of bar number 6, so we would have not entered a long trade anyway.
7. The open and close are not at nearly the same level and the close is nearly half way down the bar and is not higher than the low of the previous eye! The nose does protrude from the prices, but because of the position of the close this is not a pin bar!
8. In contrast, the close of this bar IS within the previous eye, but it is still half way up the bar! The nose also doesn't protrude much beyond the previous prices. Overall, this would not be a good pin bar to play.
9. Open and close are near one end and are enclosed by the previous eye. The nose is nice and long but fails to protrude from the surrounding prices much, so it would not be a good pin bar.
10. The open and close are near one end of the bar. However, the nose does not stick out. Not a pin bar.
11. This looks promising with open and close near one end of the bar. They are well placed compared to the first eye on the left. The nose sticks out a bit. This bar isn't at a swing high or swing low or at confluence, though.

Which of these pin bars should a beginner play?

The bars numbered 1 and 5 seem to have the best form and have the best long noses that stick out from the surrounding prices. If you are patient over this one month period two pin bars would have been played. They both would have worked well with lots of potential for profit. **YES** it is easy to say this in hindsight but **LOOK** for the good pin bar formations while you are trading and try it out. (While trading GBPUSD over this period I personally only took the pin bar labelled 5 and this was the only daily pin bar I traded on the GBPUSD for that period.)

Some final thoughts

Remember that it is fine to trade less frequently than everyone else. If 90% of forex traders will fail it is because many of these traders have 'an itch' to trade and feel that they need to be making many trades to make good money. Do not be like them. Select the best pins and aim for longer time frames if you want to gain money. When Jim is providing trading examples he explains that good traders should be hunting with a rifle from the bushes – they wait for the best setup (using pin bars in this case) then nail the trade. Over a one month period you may only find one good pin bar setup for each currency pair. If you look at six currency pairs this would be six good pin bars in a month. This might be all you trade for the month but traders can still make good money by exercising patience this way.

Jim recommends that traders who are new to using pin bars use the 4-hour time period as the minimum time period and only try trading on time frames smaller than this when more experienced. Daily and weekly pins are better and are more reliable. Also note that if you trade with longer time periods you will have much larger stops; the range of price movement in a 1 week period is considerably greater than the range of price movement in a 4 hour period. It may be necessary to carefully select a broker that allows you to have micro-lots (\$1000 lots) so you can put on a position size that suits your risk. (Some brokers such as Oanda.com which allows you to take a position of any dollar size! This is not a recommendation as to which broker you use but to point out that a trader with a small account size **can** efficiently manage risk even with large stop losses.) Playing daily or weekly pins also means that you are not glued to your computer. You can check in a couple of times a day to monitor your trades and shift your stop losses as appropriate.

For more advanced techniques for using pin bars, please see the Advanced Tutorial and read through the James16 Chart thread (at forexfactory.com).

Demo trade pin bars first. When you can trade them profitably for 3 months then open a small account (with a broker like Oanda.com that provides a lot of flexibility in position sizes, or another broker that allows micro-lots to be traded). Trade with the money in this account until you can trade profitably for three months. Make sure you are using small position sizes when you start to trade using real money. Then begin to trade with your full size account or with larger position sizes.

FijiTrader at the forexfactory forums (and another instructor of the James16 Group) has recommended to some new traders that they start trading risking a small amount of their trading capital with every trade. An appropriate level to start at may be 0.5% (yes, half a percent) of the trading capital. This allows new traders to become used to the emotional and psychological aspects of trading real money. Each week the amount risked may be increase by 0.1% until the trader reaches a position size that they are finally comfortable risking on each trade (probably 2-3%).