THE TUNNEL METHOD

1. On a 1H chart place 3 EMAs: 169, 144 and 12. The 144 & 169 create the tunnel. The 12 is a filter. (More on that later.)

2. Memorize these Fib numbers: 55, 89, 144, 233 & 377.

3. When price breaks ABOVE the upper boundary, buy. When it breaks BELOW the lower boundary, sell.

4. Stops and reverse are placed on the other side of the tunnel.

5. As price moves in your direction, take partial profits at the 55, 89, etc., with the final amount left on until one of the following conditions occur: (1) 377 is reached, or (2) Price returns to the tunnel and violates the other side.

If you stick to this basic model, your account will grow very well over time. Vegas was built with far worse odds in their favor.

This model cuts your losses very short, limited by the width of the tunnel. Conversely, you take some quick profits at the 55 level and you've positioned yourself for bigger profits in the long run should the market keep going in your favor. You are letting profits run.

The weakness is when the market chops around the tunnel and gets you in and out multiple times for small losses. I will cover how to deal with this in the filters section.

THE FILTERS

1. The 12 EMA. When everything is at the same price (tunnel, current price, 12 EMA) sit up and take notice. This combination shows *time*, the *square of time* and *price* all in balance. When price breaks away from the tunnel, there is a very high probability of a strong market move coming. (We define ‘same price’ as being within 5p or so of being equal.)

2. We do not open new ‘Tunnel’ trades during the Asian session. Positions that are open are monitored as normal. We will take profits if fib levels are hit. Chop-chop in Asia will eventually cost you.

3. Significant news days are avoided. Only 1 day per month qualifies,

the US NFP, which comes the first Friday of each month. Positions that are open that day are monitored as normal.

4. When the tunnel is very narrow (most of the time), avoid putting your stop exactly on the opposite side. If you do, you get whipsawed to death. Use the hourly charts and the most recent hours of S&R to make the call. If you’re a new trader, this will be the most troublesome filter. If you’re not familiar with trend lines, triangles, flags, pennants & S&R levels, then educate yourself and come back. But, knowing this technical stuff is not a guarantee that this will be a walk in the park. Every model has vulnerable areas that can increase losses. For tunnel trading, stop placement is one of those. Placing the correct stop is an art, not a science.

5. We look for clean moves (1 bar) through the tunnel. This means you’re into profits almost from the get-go. You will not always get the clean moves. The longer the market stays in the tunnel chopping around, the higher the probability our entry decision will be made on a break of S&R instead of the tunnel boundaries.

6. We do not trade minor (counter-major) trend signals in a strong up or down trend. If the GBP/USD is in a strong price uptrend, we will not initiate new short positions on a break of the lower tunnel boundary. Why? Because the probability of success in getting past 55 from the EMA is not very good. Past history tells us that, so I'm not looking to be the hero here and say "This time it's different." When market comes back through the tunnel on the upside, we will get back in on the long side.

In a range-bound market, we trade both sides.

That's it.

Why 1 hour charts? Smaller TFs lead to more false positives, which translates into more losses. Trading a 5M chart, the bank has you on a string and your account is going to go to them. Longer TFs, (daily & weekly), produce too much slippage. Sometimes it's tough to see how a market trades in a 4H chart, so I prefer the 1H for its simplicity.

Why 144 and 169 1H EMAs? It's all about momentum over the short to medium term. Lower EMA trading signals are too short-term to trade profitably—i.e, the dreaded whip-saw, going your way for 3 minutes & 6p, then rolling over & crushing you. Higher EMAs produce signals that are too long-term, giving you one signal a year.

There is another reason: W. D. Gann. Gann was big on squares, square roots and the inter-relationship between price and time. I am not a Gann disciple, but you can't dismiss his work. After all, the guy made $50 million between 1910-1950. He deserves respect, even if you disagree with his methods.

So, 144 is the only fib number that has a whole number square root (12). The closet fib number to this square root is 13. The square of 13 is 169. The tunnel is now created.

But, the proof is in the pudding. In a trending currency market (which is what it does most of the time over the long run), retracements are where you can re-establish profitable positions. Go back and look on the 1H charts and see where the retracements stop, and you will need to know nothing more about Gann or anything else. They stop very close to, if not exactly on, the 144 and 169 1H EMA—The Tunnel.

THE FIB NUMBERS

The truth is that moving averages are lagging indicators. It makes no difference the type, they all lag. Only after the fact can they tell you the market has turned. Even though that's valuable information and is acted upon by taking a position, it isn't going to help you much in getting the best profit potential out of your trade. If you use them exclusively to then get out, you will discover two things: (1) You get chopped when you had a profitable trade at one point, and/or (2) They took you out on a retracement and now you don't know what to do.

I can sum up everything you need to know about fib numbers and the corresponding fib ratio of 1.618. Nature and the physical universe love them. They are everywhere from the pyramids, to mountain ranges, seashells, forests, etc. So why not markets?

Fib numbers are real-time. They do not lag. When price hits a Fib number from the current EMAs, it is telling you that *here* is a natural stopping point, please take some profits off the table. When a market blows through a fib number, like a hot knife through butter, it is giving you further information—telling you about momentum in the move. Currency pairs that are more volatile than others will reach the higher fib numbers more often than the less volatile pairs. Therefore, I trade the more volatile pairs because they go to extremes more often than the other pairs. These extremes (233 & 377) produce whopping profits on a regular basis.

What the higher fib numbers are really giving you is that very important equation: price = information. They are screaming “exhaustion.” If you do the research, you will see that PA, after hitting these levels, almost always involves retracement or the start of a bigger move in the opposite direction. Is this not valuable information?

If you trade less volatile pairs, you may want to include the 34 level in your profit-taking. If you don't, you may be giving up too much.

Now, that's all we use. Can you use more? Can you invent your own? Can you change some of the definitions? Yes, absolutely. Invent your own filters, use an Elliot Wave filter, anything you think will help your trading.

SUGGESTED MODEL SYSTEM

At a minimum you should trade with 3 units. Take 1/3 off at the 55, 89 & 144 levels. If you can do 4 units, use 55, 89, 144, and 233. 5 units is the preferable level, letting the last one ride until crosses over the tunnel boundary or it reaches 377.

Of course, you can make your units any size you want. For smaller traders, a unit size may be 10,000. If you do not have the money to trade 30,000 of something, then I would advise you to save up and come back when you do. If your account has $2,000 in it, you can easily implement tunnel trading with 10k units.

One of the greatest advantages of this model is its flexibility to allow you to choose the level of risk/reward you desire in trading. You can make this as aggressive or as conservative as you want. I’ll give an example of each. These are just examples, I'm not saying you have to do this. I'm only giving you these two to stimulate your brain. In the following days and weeks I’m sure you will find your comfort level.

1. Very Aggressive. Tunnel is pivot level for buy/sell. Above tunnel, buy breaks, sell at fib numbers. At 233 and 377, fade the move for retracement. Below tunnel, sell rallies, buy at the fib numbers. Use previous fib numbers in the move as stop loss points. This is very aggressive, and would be appropriate for very short-term traders who have a time-frame of day-trading.

2. Very Conservative. Use the basic tunnel system, only entering on the 12EMA cross signal. Trade three units. Use Fib numbers 55 & 89 for 1/3 each. Leave the other unit on until 233 or market price crosses over tunnel boundary. Allows you to catch short-term (1-5 day) profits, and also allows you to ride the major trend if one develops.

When you get right down to it, once you have adapted it into your own trading style and personal risk model, tunnel trading will give you all you want. Momentum to catch the bigger moves over time, early profit points that allow you to catch short-term movements, and the lowest risk you can possibly have in a trade, because you are only risking 10 -25 pips on each trade. If your odds of success on each trade were 50-50 (they're actually higher), over time you would make a fortune. If you don't believe me, then do the math.

Precisely because of this flexibility tunnel trading is the best model I have ever seen.