

Understanding forex trading signals - and how to recognise the good from the bad

An ability to predict the future would undoubtedly make most professions easier - but few more so than foreign currency exchange (forex) traders. In layman's terms, forex traders stake a living on buying and selling international currencies, and being able to predict the price rises and falls between them.

Temps de lecture : minute

13 January 2022

As they can't predict the future, forex traders need all the tools and help they can get. One popular resource is a forex trading signal. To an outsider, these may look like nonsensical lines of code: see the example below.

BUY EUR/USD @ 1.1240

But for traders, forex trading signals are essentially short messages containing a piece of information that provide pointers for the trading decisions you have to make. Here, you can see the direction of the order, 'BUY'; the trade instrument currencies it refers to, 'EUR/USD'; and finally, the sale price, '1.1240'. These messages ping over to traders, via email, SMS, or even Whatsapp, and essentially help guide their decisions.

We break down what you need to know about forex trading signals, understanding some of the different types you'll find, and how you can know which ones to listen to.

Automated versus free: what's the difference?

There are two main types of forex trading signal: normal and automated. The main difference really is that automated trading signals will execute the trade on your behalf. Certain providers may also notify you of other factors, such as low or high volatility, or volume.

There are a number of advantages of using automated trading signals. For one, they're a good way to improve your own analytical approach to trading: you can understand the analysis that took place to influence the trade, and their outcome. At the same time, you're making money in the process, something that may not apply when you are first practicing trades. These signals can also be helpful to swing traders (those whose trades may take weeks or months to register profits), who aren't able to constantly watch the markets. You're also not at risk of your emotions coming into play: trades are executed by mathematical formula, removing that human error.

There are a number of disadvantages, however. One side effect is that it makes you a lazy trader. You can easily become reliant on signals and never spend time analysing the markets yourself in order to look for opportunities. They can also be an expensive service, an important consideration for traders early in their careers. But most important of all, you can't always trust automated trading signals. Technical and fundamental signals can be wrong, while viruses, system errors, or malfunctions can often end up costing you money.

It's for that reason that many traders look to free forex trading signals. So can they be trusted?

Free forex trading signals: who can you trust?

Most traders will start by Googling, 'best free forex trading signals'. You're likely to come across free signals on website forums or social media platforms like Reddit or Twitter. Using free forex trading signals can help you maximise profit, as well as enhance your analytical skills as a trader, but can come with a risk.

For one, it can be hard to know which free trading signals to trust. You should start by looking at who has authored it. Authors tend to fall in one of three categories.

First, there are traders. These are the most trustworthy sources of free forex trading signals. Many traders are often inclined to share their own ideas with the outside world, as a way of bolstering their reputation as a trader, or just to support the forex trading community.

Then, there are affiliates. You may gain access to these if you've signed up with a broker, who can make a profit if the trades you make, while the signals remain free to use. It's worth being wary of these groups, as it can be tricky to maintain the quality of both their own individual trading, as well as the signals they're providing. For this reason, it's worth testing these signals out on a demo account.

Thirdly, there are scammers. It goes without saying to avoid these signals at all costs. These signals are designed purely around making an affiliate commission from you. Classic scammer behaviour is sending half the audience 'BUY' orders, and the other half 'SELL' orders. This way a scammer can split their audience in half, of which 50% are going to be profitable and another 50% will end up losing. Beware of those offering a few free trading signals as a way of luring in customers.

Identifying the best free forex trading signals

If you're looking to differentiate the good from the bad, here are four key things to look out for when looking at free forex trading signals:

1. The number of positions. A minimum of 100 positions is preferable to give a good understanding of the signal service over a broad range of market conditions.
2. The risk to reward profile. It is important to make sure that the provider has a positive ratio between the risk taken and the potential profit. As a general rule, a ratio of more than 1:1 risk to reward is favoured.
3. The success rate. To know the behaviour of the signal service, we want to know if the system wins very often (more than 70% of trades) or less often (50% of the time). This is to make sure the signal provider has not just had one very big 'lucky' trade.
4. The number of consecutive losing trades. This is the drawdown or potential loss that can occur when following the forex signal in question.

These four elements are by no means a guarantee of success. You should use the trading process as a chance to inform yourself as best as possible, and consider free forex trading signals an asset to learning more about the market, rather than something to depend on. Ultimately they'll lead you towards making better informed decisions around which trades you choose to execute. Good luck!