How To Spot Contrarian Trading Opportunities Using Sentiment Analysis
When it comes to the forex markets, many traders choose to follow the herd by buying when the trend is established. However, it's important to remember that once a trend is obvious, many smart traders may already have their positions in place, which means there will be a limited number of investors left on the sidelines who can come in and further drive the trend. Professional traders know this, which is why they often look to fade the crowd by trading against the trend when it is showing signs of exhaustion. This style of trading is called contrarian trading.

What is contrarian trading?
Put simply, a contrarian strategy trades against the current market trend. Contrarian traders are looking for points where a trend is likely to reverse by buying currency when the price is low and selling when it’s high. This buying or selling often occurs at major support or resistance levels respectively.

A key benefit of contrarian trading is that it can lead to very attractive reward-to-risk ratios because you get into winning trades early. Because of this, it’s critical you have a method for letting your profits run.

However, it’s important to remember that contrarian trading is far from risk free, because when you’re trading against a particularly strong trend, the price can sometimes break through the potential reversal point, stopping you out of your trade. Because of this you need to cut your losses quickly if the trend continues in the original direction, or you could face large losses.
Many retail traders have a natural predisposition to a contrarian trading style, but they often lack the necessary patience or skills to execute successfully. By way of example, the chart below clearly demonstrates how the retail crowd attempted to buy at earlier support and resistance flip zones, however without the right tools they have failed to convert this into a successful strategy.

This is likely because they didn’t cut their losing trades quickly enough, or allow their winning trades to run (see later explanation).
Catch the crowd off guard with sentiment analysis

In order to catch the crowd off guard, the first step as a contrarian trader is to gauge market sentiment on the Open Order Indicator. This is clearly displayed in the top left corner of the chart and the percentage of trades who are long versus short. Once these levels reach extremes of more than 70 percent one way (for example more than 70 percent of traders are buyers), you might consider fading the market.

The next step is to look for a major support and resistance levels. If a large number of buy orders are sitting at support – or a large number of sell orders at resistance – this could confirm the countertrend trade idea.

Smart traders wait for sentiment to reach extremes and a large number of orders to sit at a major level. When these factors combine, the contrarian trade idea can be executed. However, once the set-up conditions are in play, it’s worth being patient and stalking an entry rather than entering right on the level. Many traders prefer to wait for the price to reverse in their favoured direction, which can often be seen in the form of basic candlestick reversal patterns.
However, the entry is not the only answer to being a successful contrarian trader, and traders must learn when to cut losses and how to hold on to their winners. There are several basic trade management techniques that can help.

Trade management essentials
Trade management is the art of knowing when to hold and when to fold, and is one of the most influential parts of any trading plan. This is because when managed poorly:

- A good entry could turn into a large loss
- A big winner could turn into a small winner

Successful contrarian traders keep their losses small and their winners big. There are two key steps that help achieve this:

1. Put a stop loss in place to ensure any losses are well contained. OANDA’s MT4 Open Order Indicator can help provide insights into where you should place your stop; simply identify a point a little below the large group of orders sitting on the major level where you are looking to enter your contrarian trade idea. By placing your stop behind these orders, you are giving it a degree of protection because the price will need to break through the supply of orders first before you are stopped out.

2. Identify a method to allow your profits to run in order to benefit from the superior risk-reward opportunities this form of trading provides. Contrarian traders often get stopped out while they are trying to find the bottom or top, so it’s very important that when you do get on a winning trade, you win big.

The MT4 Open Order Indicator can help here too, and you should consider keeping your trade open until sentiment reaches extremes on the other direction. For example, if you bought when 70 percent of the market is short, look to hold your position until sentiment has switched to 70 percent long, when the bull trend is showing signs of exhaustion.
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One approach is to identify key buying or selling levels where large orders are grouped and place your profit target there. For example, if you are buying, look for a major resistance above your current position and hold the trade until the level is reached.

Another option is to trail your stop loss behind your winning trades, ensuring it is kept well out of the way in order to avoid being whipsawed out of your winner. If any major levels form below your position as seen on the Indicator, you might consider moving your stop behind those.
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The OANDA MT4 Open Order Indicator advantage
OANDA's MT4 Open Order Indicator can easily be used to add a competitive edge to any trading strategy, because it helps traders quickly identify contrarian buying opportunities on the price chart by following these simple steps:

- Wait for sentiment to lean more than 70 percent in the direction of the trend
- Identify a major level with a large number of orders that will support your contrarian position
- Wait for the price to reverse off the level, possibly by identifying reversal candlestick patterns
- Place a stop-loss order behind the level
- Let your profits run by waiting for sentiment to be oversold, identifying a likely profit target area and using a trailing stop

A new era in retail trading
Available exclusively to OANDA clients, the proprietary MT4 Open Order Indicator reveals critical information never before available to the retail trader. By presenting an overview of current buy and sell orders placed by OANDA traders directly on your MT4 charts, the Indicator enables traders to capture market sentiment, identify large order clusters and trade contrarian trends. This effectively stacks the odds in your favour by providing access to the same strategies typically used by institutional traders and interbank dealers.

To learn more about OANDA's MT4 Open Order Indicator, please visit oandaMT4.com.
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