

# The Anatomy of a Forex Trading System

## What is a Forex Trading System?

Quoting from [Wikipedia](#), “A system is a set of interacting or interdependent entities, real or abstract, forming an integrated whole.” The concept of an “integrated whole” can also be expressed in terms of a system embodying a set of relationships that are differentiated from relationships of the set to other elements, and from relationships between an element of the set and elements that are not part of the relational regime. Sharing the same common characteristics, most systems:

- Are abstractions of reality
- Have a structure that is defined by its parts and their composition
- Have behaviour, which involves inputs, processing and outputs of material, information or energy
- Have parts with functional as well as structural relationships between each other
- May also refer to a set of rules that govern behaviour or structure

A [forex trading system](#) is generally considered to be a set of trading rules that control when and at which price you open and close the currency trade. “A system is simply a plan or set of rules of when to buy and sell currency”. (Charles D. Kirkpatrick, Julie R. Dahlquist. *Technical Analysis*). An example of a rule would be “buy when a moving average crosses above another”.

Variables are the quantities used in the rules - two moving averages, and the parameters are the actual values used in the variables - 5minutes and 15minutes. “A system lets us determine a priori how it will react to particular market situations.” In an ever-challenging forex market, a trading system is more complex than just a set of trading rules. The system must also include the means of controlling the risks of losing capital, mathematical models, historic data, and sometimes specialized software. A system is an “integrated whole” that consists of key elements, relationship between internal elements and relationships with external elements.

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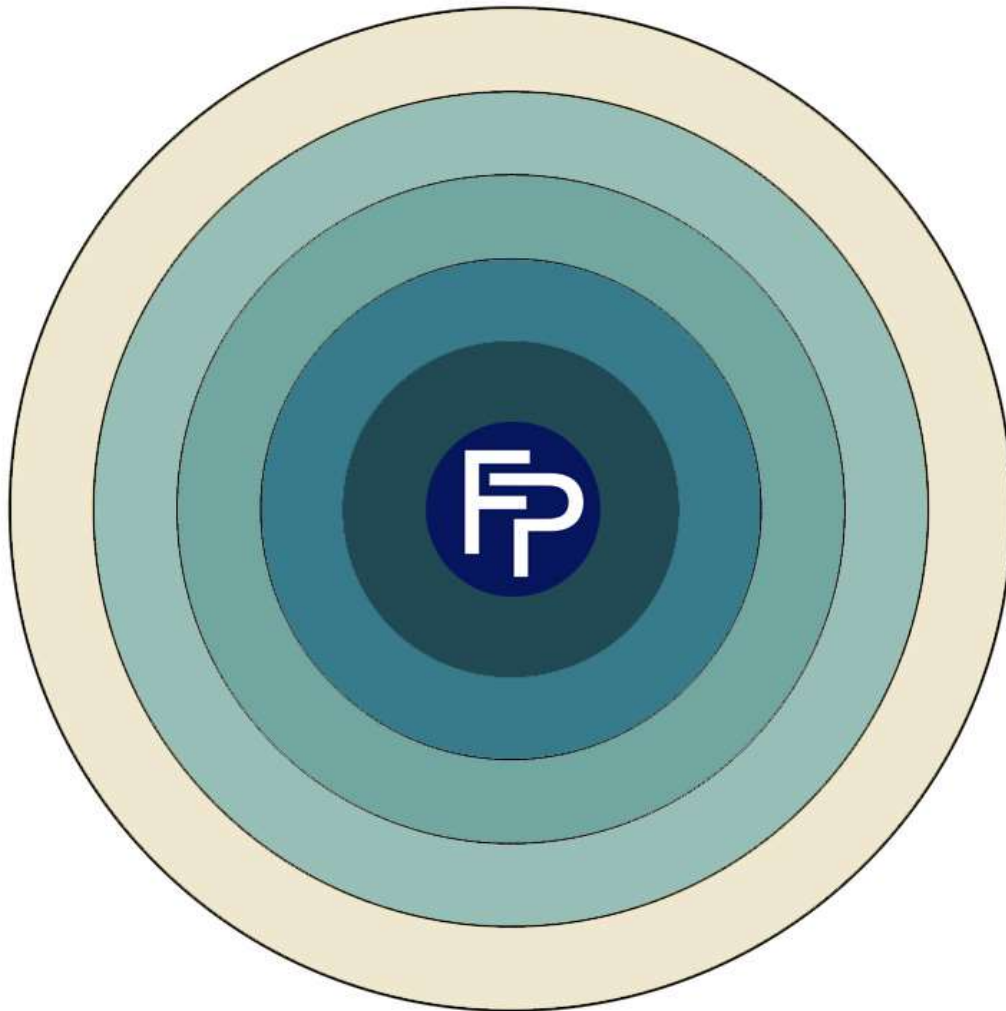
A U.S. military strategist, John A. Warden III, introduced the Five Ring System model in *The Air Campaign* contending that any complex system could be broken down into five concentric rings. Each ring - Leadership, Processes, Infrastructure, Population and Action Units - could be used to isolate key elements of any system that needed change. The model was used effectively by Air Force planners in the First Gulf War. Using Warden’s book as a model, you can break down a trading system into the following levels:







- Investment philosophy
- Trading strategies and mathematical models
- Risk management and money Management
- Disciplined processes
- Back test and Optimization
- Financial data and trading software

Consider each level of system or “ring” as one of the forex trading system’s centers of gravity. The principal idea behind the six rings is to develop a trading system that earns a desired profit in a targeted time frame. To accomplish this goal, there is a need to address each of the rings individually and collectively to build a robust and profitable trading system. The system developer needs to engage as many rings as possible with more emphasis on the inner rings.

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## ANATOMY OF A FOREX TRADING STRATEGY



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|---|--|
|  Investment Philosophy |  Disciplined Processes    |
|  Trading Models        |  Back Test & Optimisation |
|  Risk Management       |  Data & Software          |

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