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Parabolic Trading System

This particular technique has been around a long time and is still widely used by many analysts because of its adaptability to most markets.

History

The parabolic time/price system was first introduced by J. Welles Wilder Jr. in his book 'New Concepts In Technical Trading Systems'. It is very often referred to as the SAR system meaning stop and reverse. This means when a stop is hit the system reverses so it is permanently in the market.

The actual point at which the system is reversed is calculated on a daily basis (or whatever time period you are looking at) and the stop moved to create a new reverse point. The SAR point never backs up. In other words if you are long the market the SAR point will increase every day. The same is true for short positions. This is the time part of the system.

The other important part of the system is the speed at which the SAR point moves. If the market is moving fast the SAR point will move slowly at first and then increase as the market moves higher, this is the price part of the system. The rate at which the system increases is called the acceleration factor.

It is beyond this lesson to give the exact calculation of the acceleration factor and it is not really necessary to know the formula as most charting services now incorporate the system in their indicator range.

Example of what SAR looks like.



My Use Of SAR

So far so good. The system is simple to trade and is very visual so it's easy to know when you should be short or long. If the SAR point (dots) are above the market you should be short and if they are below the market you should be long.

Here's the problem! It doesn't perform very well in the markets I have tested it on nor do I know any traders who trade it as a stand-alone system. Maybe in the markets of the past it would have worked well but not so now. The problem is there is just too much whipsaw.

Now you may be asking if there is too much whipsaw why mention the system at all? Good question and here are two reasons I find a good use for the system.

The system can be very effective if a filter of some sort is used. In the example below of the eur/jpy I have used a MACD as a filter. If we were long the market then only long signals would be taken and the short signals ignored as long as the filter (MACD in this case) remains long. If a short signal is triggered but the filter still remains long you could close the position and wait for the next long signal. The reverse is true for short positions. You could use any oscillator you feel comfortable with or even trend lines.



Sometimes it can be very difficult to find a good place to put your stop. With the SAR system you will always know exactly where to place a stop and it will increase everyday to help lock in profits. It also gives the move enough room for market corrections without taking you out of the position. I like this particular method if I have a long-term position which; I only want to check on once a day. I can quickly check how the position is and then move my stop accordingly.

I am sure you can find many other uses for the SAR system and its well worth playing around with the parameters to see if it can be added to your trading arsenal.
Good Trading

Best Regards
Mark McRae

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