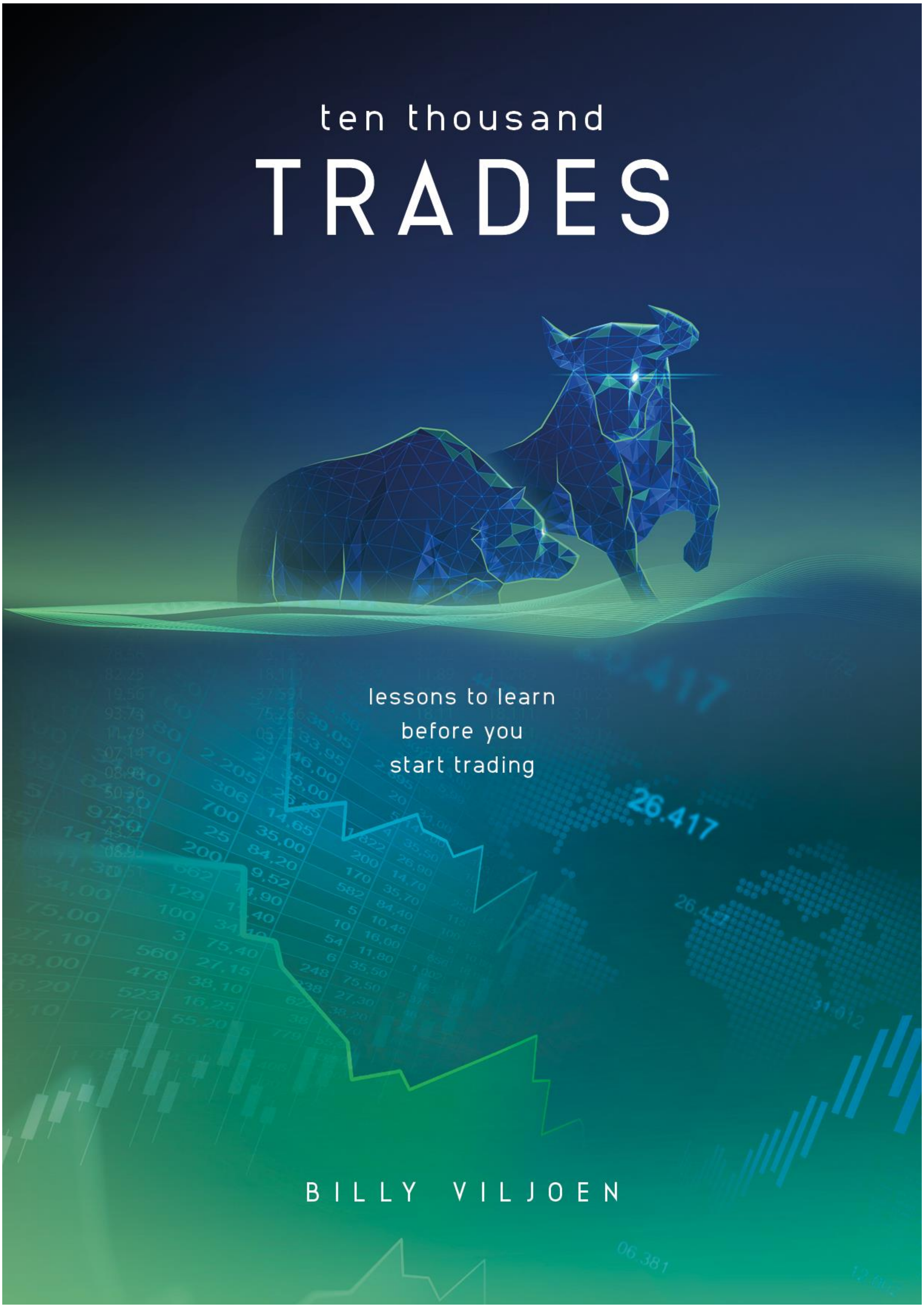
ten thousand
TRADES
lessons to learn
before you
start trading
BILLY VILJOEN

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INTRODUCTION

You don't have to be a brain surgeon to know how volatile markets can get. I guess the point I am making is whether you trade globally or locally, you need to understand an age-old saying uttered by a famous economist:

> ***"the markets can remain irrational longer than you can remain solvent".***
>
> John Maynard Keynes

How on earth is anyone to understand such a complex mess, how can you possibly cover all the blind spots?

Well the good news is that with proper context and a solid trading and risk management plan this is not impossible. You will find that the markets ultimately just don't like any "unknowns", but as soon as the mess has filtered through the system and is understood, no matter how negative, the traders are able to make decisions and start trading again.

Well, professional traders that is, for retail traders it's a bit harder. It is also important to understand that most people react irrational most of the time. Fear and greed still drives the underlying emotions of any novice trader resulting in them to either shy away from the financial black holes or irrationally jump in with both feet in it – in both cases, ironically enough, either due to ignorance or a lack of understanding.

Well there's a third emotion which is best captured by the current short hand smart phone craze and that is FOMO – – FEAR OF MISSING OUT!!!

So let's kill one of the above points right here and now.. don't ever have a FOMO moment.

You will learn that there are always other trades, there are always ways to get into a trade you've missed, and a golden rule to follow is *trade only once you are ready to do so*… until then just sit back, relax and keep looking…

Think about the following concept an extraordinary successful and famous trader Jesse Livermore once quoted …

> *"money is made by sitting, not trading" and "Nobody can catch all the fluctuations"*
>
> Jesse Livermore

I know, I know.. you want to get trading and I am blubbering on about stuff you guys don't REALLY want to hear about, at least not now.

So here's the deal, I will try to get you trading as quickly as possible. In fact I can tell you straight away how to do it….. but this is not about me telling you, this is about you starting your own journey, if you want to, on how to become a successful trader.

You see, trading can be a bit of an enigma. The reason being that randomness and luck could play a dangerous role which has the potential to spell disaster, especially when someone is just starting out.

Before placing your first trade you need to understand how to manage two things, your ***emotions*** and your trading ***capital***. This by far is the most important lesson I can ever teach you as a trader. Everything else is a by-product of this….

I will show you that you can start from practically anywhere. You can start your trading while doing your day job, saving up to have capital to trade with. You don't have to wait until you have tons of money to start… just start!! The beauty of time and patience will reveal itself.

Unlike what you will most likely still see all over the place, trading is not supposed to be a get rich quick scheme. It can happen that you strike all the right cords and accumulate phenomenal wealth over a very short period of time, however this is not what I am here to show you.

That type of trading requires a phenomenal amount of time spent in front of the screens following every single heart beat the market makes, trading in and out of positions constantly. Spoiler Alert – most people don't have the mental stamina to survive that game in any event and end up failing.

Besides, that's just not my deal any more, I have reached a stage in my life where I have seen it all, I know what works, and I know how important it is to reach a balance in your life.

So the method I will show you is slow and steady, how you can still attain the goal of accumulating wealth without ever losing a minute's worth of sleep over it. This is achieved by never taking excessive risk. In fact, I know that what I will show you can probably be classified as boring. But in this game boring is good, trust me.

As eluded to before, the reason I show you these methods is due to a thorough understanding that, when starting out, you will most likely not be able to afford committing that much time, dedication and effort to trading. So one would require a simple process, powerful enough to move you along the learning curve as most of you have a full time job or are perhaps studying or something similarly time consuming. This fact should not preclude you from enjoying the joys and thrills the market can offer, with the added possible benefit of a major source of wealth accumulation as you go.

In his book "Outliers" Malcolm Gladwell discusses the idea that for anyone wishing to achieve world-class expertise in any particular skill, it boils down to a matter of practicing this skill over and over, for a total of around 10,000 hours. So this book is about showing you how to "stay in the game" for the 10,000 trades it will take you to master the skill of trading.

A perfect trading strategy exists, and the best part is that it's simpler than you've ever imagined…

Ready?,…. Let's go

CHAPTER 1 – MANAGING YOUR EMOTIONS

Why do you want to trade? In my experience and for the broader population out there, for many it is to experience the adrenalin rush when the market moves in their favour? For some it's a game of wits, where they try to outsmart the market. Some people are just wanting to change their stars.

My own core belief is that financial markets are a source of immense wealth, and trading is the tool we use to harness it, to generate true wealth.

Regardless of the various motives and whatever the reason, I think we can all agree that many traders go through a flurry of emotions every time they pull the trigger on a trade. In that instance of time, we all become a "professional" trader all of a sudden.

In fact I remember as if it was yesterday, my first introduction to having proper "skin in the game".

The Day I Learned This Lesson

In 1998 at the age of 24 I was fortunate enough to be accepted onto the graduate training program of a major bank. I was one of a handful of people who were placed inside the dealing room of the bank on a rotation basis across all the various trading desks. By then I had already had a good few years of investing in the stock market under my belt. In fact, the financial markets have always been in my blood. I recall that in primary school, well before the invention of internet and websites, I used to run to the school library during break to check up on what the sugar prices did the previous day. Though too young to trade yet, I instinctively knew that I liked the markets.

In any event, so here I am, sitting on the gold desk amongst some of the most seasoned traders around. I recall at the time the bank had probably one of the most well renowned and globally respected commodity dealers employed heading up the trading desk. This guy was phenomenal. His trading skills were only surpassed by his ability to do mental math. He used to walk past his traders and each one was to shout out their individual book positions and by the time all were done shouting out their net positions, he would be able to calculate the average position of the entire desk right there in his head!!!

Anyway – so sitting on the desk, next to the traders I found myself looking at their trading screens ever so often, but mostly listening to the general chatter between them and other market participants and clients. Soon enough the head trader (Mental Math Guy) sat down next to me and said, "so have you been following the gold market of late?". Me, in true form and being the smart-arse that I am did not skip a beat and began to tell him my views on the market.

My First Big Trading Ticket

So without any emotion he asked, "so if you could, would you go long or short here?" (Long as you will later learn is to buy the particular instrument, where short is to sell).

I blurted out, "of course I'll go long…."

At that very moment Mental Math Guy leans into the squawk box (which is basically an intercom system connecting his desk to the brokers) and shouted, "mine at the figure please".

He calmly turned to me and said – "let's see how this turns out" and proceeded to shout out this newly opened trade to the position keeper on the desk as he got up and walked away.

WHAT JUST HAPPENED??????????????????

I felt this unbelievable rush of adrenaline. I was completely out of my depth. From the second he left I was literally GLUED to the trading screens. I recall watching every single pip the market price moved with, every up-tick giving me a sense of relief and a down tick, an agonising sense of "oh crap"!!!

I could not believe why the other traders around me just nonchalantly went about their business. Surely they were running positions a thousand times larger than mine. How can they be this calm?

Unbeknownst to me Mental Math Guy was teaching me one of the biggest lessons, and by far one of the most important ones of my entire financial career.

He was never interested in the outcome of my trade, and in fact, it was absorbed into the total desk position without me ever being asked if I was right or wrong.

Finding Your Level of Trading Comfort

Being right was not the goal. In fact, losing is part of winning when it comes to trading, and the sooner one accepts this fact the better.

Instead, what he wanted me to realise was that I had an internal level of trading comfort. A personal "stress-o-meter" above which trading is a VERY uncomfortable game.

Trading a position size above your comfort level puts you in a position of internal anguish and stress. It will make you blind to reality and leave you with only one single, laser-like focus on one desired outcome,... to survive the trade!!!

It's relevant to note that these lessons you don't get to learn properly while Paper Trading either.

Fact is, you will be so stressed that taking a loss will not even be an option to consider, one will much rather add to a losing position in the hopes to trade your way out of it, than to see a loss of that magnitude. THE ABSOLUTE WORST PLACE TO BE!

The Importance of Taking Things Slow

I very quickly learnt the importance of new traders spending time as interns on a trading desk, then from there go on to be a junior trader, and slowly working their way up over time to trader level, and eventually senior trader etc. I did not realize it in the moment but looking back can see the logic of allowing an individual the space to build their mental agility and confidence.

For this very reason I will show you at some later stage exactly how to curb your own fears, how to protect yourself FROM yourself. How to manage risk and trading size so that every trade is "just another trade". You will never be held hostage by one single trade, or collective position. This is a crucial space to operate from as only in this space can one make free and clear (emotionless) decisions.

The reason this is so important is that trading can add an immense amount of stress to your daily life if your goals are not aligned with who you are, personally at your core, your own tolerance for risk and appreciation of reward. If there is a massive mismatch between your core being and your trading style you will find yourself forever chopping and changing strategies trying to chase the next trade while balancing this level of discomfort. Sleeping soundly will be something you'll recall doing BEFORE you started trading.

This often can be avoided by following this simple step.

What Is Your Trading Personality?

Measure your success in the market, against the real reason you are in the markets in the first place.

If you are only there for the thrill of the ride then I would bet that your emotions towards trading can be compared as exactly similar to those you express towards gambling.

For most of us though, this reflection often brings with it a sense of frustration trying to align these two worlds, I know,.. I've been there.

Often a slight course-correct is necessary, and it could be as simple as a different trading style or adjusting the size of the positions you take! It is far better to fix any misalignments now when you are starting out, than to continue onwards on your journey without any clear direction of what you want from trading.

In the end, the only way you will end up trading over the long term is if you feel a sense of progress, motivation and achievement from your actions. Yes, there will be down days for sure as well, but if all you are doing is holding on to your seat while experiencing a whiteknuckle ride in the markets every single time you trade, I can bet you that this too will be a short lived venture.

I find that the best way for me to tackle this was to accept the fact that I was not in it for the short term. That I wanted to build wealth consistently, so my focus was not on finding something that worked once, but instead could be repeated regardless if markets goes up, down or sideways.

A good friend once told me "never try to boil the ocean, boil a single cup of water at a time".

Such a simple statement, but its power lies far deeper than just the act of simplicity. First, it allows you to succeed, which is critical. One is far more likely to continue with something if you have achieved small, frequent and measurable successes. Boiling a cup of water allows you to see results, and get the emotional validation that you can do that step, which allows you to move on to the next….

Trading is similar. ***You are not there to win every single trade, you are not there to beat the market.*** Accept that if you do not pay attention to your emotions, it will eat you up and spit you out quicker than you can say "let's double up and swing for the fences".

Fundamental Requirements for Successful Trading

Successful trading requires your attention to four fundamental concepts:

- Capital, and the fierce preservation thereof
- Control of your emotions
- A trading plan / strategy
- Time

The truth is that if you are aiming to achieve significant wealth from your trading activities, you really can't focus on any single one of these, but instead, constantly need to balance all four, like balls in the air at the same time without letting one fall.

For beginners the best way start is to find a proven "time tested" strategy that fits their personality and trading style. Set a realistic goal for your first year of trading and just stick to it. Spending the time to hone your skills will never be time wasted. As much as I had to learn what my own "stress-o-meter" levels were, you still have to. Use the time when starting out to find your feet.

Consistency being the key.

Also remember that a strategy never unfolds if you change the goals half way through. Don't look for 20 new ways of trading the market. If you are a professional, then great, fine to play around and tweak your model, but for most this is a fundamental gem of advice which will help you to remain focussed, to fiercely preserve your capital and to gain consistency in your success, all of which contributes to a healthy trading state of mind.

Don't forget the final key ingredient…..

You need TIME!!!! You cannot treat the market like it's your own personal lottery or ATM machine. Later on you will come to realise that the market has a very real and complicated function, and for you as a single small time player, it is completely unrealistic to expect the market to work in your favour at all times allowing you to make millions in a matter of months.

The lure of quick wealth gets many traders in trouble, so the quicker you can get over this illusion the better. It takes time, dedication and self-discipline to stick to the trading plan. Trading is not a get-rich-quick-scheme.

Phenomenal Traders Do Exist

Don't get me wrong, there are some phenomenal traders out there. I had the privilege at one point in my life to work alongside a many of them. In fact, one of them was the "side kick" of Michael Marcus, a world-renowned Market Wizard, during the time he turned $30,000 into $80,000,000 over the space of only a few years.

But realise this, for every single person you ever hear of achieving such astronomical results you probably can expect to read about hundreds (if not thousands) who have spent their life's savings on risky bets trying to catch the next trade, though realistically the chances of all them publishing their failure for all to read about is probably slim, but you get the picture.

Once you get to the point where you realise you are in this for the long haul, then the result of the very next trade you are about to take becomes a bit less daunting.

If you keep these trade sizes within your own "stress-o-meter" levels then it should be easier for you to accept losing trades as part of a winning strategy.

Chapter 2 – POSSIBILITY vs. PROBABILITY

The *sequence* of randomness is more pronounced and impactful across a small number of samples, in fact, the sequence of randomness can kill ya!

I know this example has been used all over the place to explain this concept of possibility vs. probability but honestly, in my opinion it's the best and easiest way to explain a basic concept which can get very technical very quickly. Thus for simplicity sake I will stick to this very frequently used example.

Flipping a Coin

Imagine for a second that you are about to play a game in which a coin will be flipped. Imagine also that you will be required to place a bet on the outcome of each flip.

First let's define the Rules of the game:

- Parameters around how the coin can land.

We can assume that a coin has "no memory". In other words, the coin itself can't recall on which side it fell the previous 1 or 10 or even 1,000 times, thus for the purposes of this example we will assume that the outcome of every single flip of the coin remains completely random, and without any ties to any prior flips other than it can only land on either Heads or on Tails (i.e. though the ***chance*** of the coin landing upright, standing on its side does exist, the ***probability*** of this happening is zero in our example)

- Available capital and size of bets.

You start off with $100 and the rules are very simple, you can bet as much as you want on any one single flip, if you called the flip correctly your winnings shall equal 100% of the amount you've placed on the bet (in other words, if you risked $1 on a flip and you won, then you will be returned $2, being the $1 risked plus the additional $1 won on that particular flip).

Further Analysis

The general laws of probability dictates that for an event with only two possible outcomes, over a large enough sample size (in other words flips in our example), the chances are that each one of the two outcomes shall appear roughly 50% out of all the total outcomes.

*The problem in this statement is that it does not necessarily state "**50% of the time**".*

Let me explain. This small variable describes the difference between probability and possibility. Though it is entirely possible that when you flip the coin 10 times, that it shall land on heads 5 times and tails 5 times, chances are that it will probably not do so every time you flip the coin 10 times.

You see, the sequence of randomness is more pronounced and impactful across a small number of samples (flips).

As an example:

It is entirely possible (but not probable) that out of 6 flips the coins can land in perfect sequence of heads, then tails, then heads and so on.

But similarly, it remains entirely possible and probable that out of 6 flips heads can show up only 2 out of the 6 times.

You see, the problem is that unless we find a way in which we can ensure we get to play the game long enough, in other words, to see as many flips as possible, the actual statistics behind the 50/50 probability of this coin-flip-game will not have a proper chance to manifest.

In our example above, when the possible outcomes were viewed over a very small sample of 6 flips only, you will agree that this randomness of probability resulted in our coin-flip-game no longer resembling the nice and comfortable risk reward ratio of 50/50.

We therefor need to amend the way in which we approach the game in order for it to return back to the stats.

The only way in which to do this is to find a way that will maximize our ability to stay in the game, in other words, to "survive" as many flips as possible that could possibly go against us.

The "% of Trading Capital" Rule

One of the most commonly used rules in trading, and for good reason, is to not risk more than a predetermined percentage (%) of your current available trading capital on any one single trade.

Unlike when investing where one would possibly apply an "equal capital rule", when trading we typically use this rule on an "equal risk" basis, in other words, applying our capital so that any one particular trade cannot lose more than the equivalent of 1% of the total value of your trading capital at that particular point in time, regardless of the actual nominal amount committed to the trade.

Why this is important to know is that any trader typically only have a set amount available to trade with, once this runs out – you're done! Unless of course you have very deep pockets and can top up your account (which brings with it various other important issues to consider and questions to ask, but that's for a different topic).

It is worthy to note that if you consistently risk only 1% of your available trading capital it will take 229 consecutive losers for you to have lost 90% of your portfolio. That is without ever having a winning trade during this time at all!

% On Risk Per Trade	Number of Consecutive Losing Trades to lose 90% of Capital	Number of Consecutive Losing Trades to Reach Draw Down limit of 80%
1%	229	22
2%	113	11
3%	64	7 - 8
5%	44	4 - 5
10%	21	2

In subsequent chapters, we will explore in detail the concept of exactly how much to risk per trade. What I will also teach you is that you will never let yourself go like this..., you will never trade yourself into the ground without allowing yourself the opportunity and ample time for reflection on both your risk parameters as well as your trading strategy.

To prevent this from ever happening we shall also incorporate a concept called "Max Draw Down against the High Water Mark".

Why this is such a benefit to consider is that this will also ensure we gradually progress forward, and in doing so also protect newly acquired capital (and not just what you've started off with).

If you consistently risk only 1% of your trading capital it will take 22 consecutive losing trades before you will hit this 20% Max Draw Down level. Clearly if you had 22 consecutive losers you definitely need a bit of a break from the markets. With a portfolio value now at 80% of original value you still have a manageable chance to trade your way back provided you reassess and adjust your risk and trading strategy by pressing the reset button.

The Tale of Two Returns

The reason why we will be paying so much attention to fiercely protecting our trading capital is not just related to the impact of the monetary loss alone but in addition, and equally important I might add, that you need to ensure you maintain a healthy state of mind throughout trading and this method supports your mental agility to ride out any emotions that may come with desperation.

In order to explain these concepts, consider the following example:

Starting with $1,000 and losing 30% implies that you now only have $700 available to trade with. This $700 is your current available capital. In order for you to trade your way back up to the original $1,000 you've started with, you would need to make $300 in profit.

To make $300 profit on $700 trading capital equates to a required return of 43%!!

Even worse, a loss of 50% on your trading capital implies that on the remaining capital you now have available, you need to achieve a 100% return JUST TO GET BACK TO WHERE YOU STARTED.

You never want to trade from such a state of mind, where such high stakes are required just to break even!!

Capital Draw-down Limit

So in addition to limiting our maximum exposure towards any one single trade, we will add this additional safety net, allowing ourselves ample time to reassess the situation with a clear mind. I would recommend you set the drawdown limit at no more than 20% of the highest level at which your trading capital ever was. This way, if you ever end up losing 20% of your capital at least your target for the next while is to only make a return of 25% which gets you back to square one, a far more attainable level than the 100% explained earlier!

Furthermore, by measuring this draw down level against the highest value of our portfolio it will ensure we protect ourselves, from ourselves, and also limit the damage of losing newly gained capital.

Taking a Holistic View

So throughout the entire process of our trading we will monitor the following three portfolio health indicators closely:

- Maximum Percentage Risk per single trade
- Maximum Percentage Portfolio Risk for all live trades on book at any one point in time (taking correlation into account).
- Constant monitoring of the drawdown percentage measured against the High Water Mark

This will ensure that we allow ourselves, our trading style or system, and most importantly our capital the space and time to experience and be properly exposed to the statistical probability behind our trading methods and thereby aim to ensure our portfolio growth trajectory remains pointed in the right direction!

Chapter 3 – What type of trader are you?

I clearly recall how I felt when I first started working in the dealing room. The learning curve was crazy steep! I felt soooooo intimidated. There literally were thousands of permutations of everything to consider when making trading decisions.

These could range from different types of trading strategies, entry and exit techniques, types of correlation, significance of pivot points, event risk, strike risk, spike risks and so on and so on. I literally can go on and on about all the variables out there and how they are all intertwined into this massive spaghetti bowl called the financial markets…

The point is, that if you get bogged down by every single thing that is out there to do, or that could possibly kill you, you will literally end up doing nothing! You have to start somewhere and build on that momentum.

There is a famous quote which by now is so plagiarised that I honestly don't know how to give credit to for it.

> *"Every expert was once a beginner"*
>
> Unknown

Translated to trading it reads ***"Every Professional Trader was once a novice trader starting out just like you are staring now"***.

So how do you get over your trading inertia?

By following the guidelines below it should cut the noise to some extent and allow you to hone into your most ideal target zone in which you would be operating most optimally. Understand of course that people are different and that what works for one does not by implication automatically work for another.

So if you hear someone professing to be a guru on the latest greatest trading strategy, don't be discouraged nor intimidated. If that strategy does not fit into the below frame of reference, then it has no relevance on your trading.

This is an important point to grasp. *You need only to become an expert in a few core strategies to give yourself a major advantage and shot of being a successful trader*. If you chop and change the whole time you will never truly get into your own rhythm.

What Type of Trader Are You?

It's like buying a car.

There are a whole range of cars out there. All serve the general same purpose but inherently all serve a different target market.

Sports cars will get you to your destination fast, but is rather useless to use when going on vacation as there are hardly room for one's ego in a car like that, let alone luggage or family and friends.

Minivans are dead ugly, but amazing when you have kids. Each kid sits on their own seat, far enough from any of their siblings which makes for a nice, quiet and peaceful drive. It has a ton of luggage space but finding parking can often be a headache.

Small compact cars are great for when you are young, with little to no surplus cash, really needing fuel efficiency, as every cent saved on gas can go towards beer…

Yet, in the end, the basic function of all the above is to move people from point A to point B. So don't confuse FUNCTION with any form of SUPERIORITY of one over the other.

Trading has existed for centuries, so why would you want to recreate the wheel when all you need to do is just choose the "car" that fits your own requirements in getting you from point A to point B? Who cares if someone else drives a different car, if it's FUNCTION does not work for your own unique and individual requirements, then why consider it as part of your decision-making process?

So, in a nutshell, your trading style will likely change as you grow, but that's not of concern to me now. The reason why I am here is to get you moving from point A to point B in the simplest way possible which is the easiest to understand, has the lowest time impact and lowest level of complexity.

Trading Style Checklist

So, let me help you choose your ideal "car" by guiding your decision-making process through exploring each of the below:

1. First and foremost, figure out what trading style suits your own personality.
2. Realistically determine how much time you wish to dedicate to trading (on a daily basis).
3. Understand why you want to trade
4. Define your market, and then your time horizon (which will be in line with points 1 and 2)
5. Create a trading plan
6. Study and master all components of your trading plan
7. Implement and stick to your plan for a while
8. Don't forget to enjoy the ride!

1. YOUR TRADING PERSONALITY

In my lifetime trading I have literally seen all sorts of people. Most talk a big game but when it comes down to it, run for cover with every opportunity they get. Their risk management techniques are as shocking as their stock selection theory. Every week they are "back testing" the latest and greatest new trading theory they came up with and for the most part are "killing it" in the markets.

Humprey Neill, the father of contrarian analysis had a famous saying:

> *"Don't confuse brains with a bull market"*
>
> Humprey Neill

For me, the single thread that cuts right through everything I will ever tell you is that you need to find what works FOR YOU!!

In the end, unless you are a money manager or a prop trader at an insto, you will always only be accountable to yourself. Your greatest competition will be yourself. The market does not care what you do, what positions you have on. In the end, you can either be your own worst enemy or your own greatest ally.

For this reason, trading needs to match your personality style. Allow yourself the time to develop your style.

How does one do that though? Well the only real way is to actually start trading.

The trick to this would be to start in a way that goes the least against your natural grain. In other words, by keeping the position size small enough that you are emotionally neutral to a win or a loss (well a little partial to a win is always a good thing)… SO, having said that, I cannot overemphasize the importance of managing your limited trading capital which becomes key while in your discovery phase.

We can however move from a safe point of departure. For the bulk of the population, it's safe to assume that, if given a choice, most people would prefer not to take a trade in which they know for a fact that they will lose. That is a given, however, the funny thing about humans are that "expecting to lose" becomes far less daunting if this loss can be predefined, and is coupled to a potential benefit for taking this perceived risk.

This is a crucial piece to understand in assisting you in getting over your initial inertia.

So in summary, its 100% ok if you don't know the answer to your ideal trading personality as yet. My advice to you though would be that until you do, focus on keeping things simple. Don't over complicate your trading by using overly complex indicators which have a ton of rules that changes with every change in another random variable.

Choose only a few indicators and become a master in those. Trust me there are plenty. In fact the basic stuff you will most likely end up using all have very minimal rules, very easy to understand, identify and execute,.. you'll see exactly when we get to that point.

2. TIME AVAILABLE TO DEDICATE TO THE MARKETS

The next step would be to realistically determine how much time you wish to dedicate to trading every day.

This is a CRUCIAL piece of information that goes into the trading puzzle as this alone can singlehandedly result in certain strategies to be included or excluded from your trading plan all together.

Broadly defined you need to decide the following:

Do you trade for a living or do you live to trade?

The choice ultimately depends on your own personal setup at the point when you start trading. Note that I am purposefully excluding the "Professional Traders" from the below classification as my reasoning is that you will get all your training via the institution you work for, and really don't need my help.

So the below is typically what one would consider "retail traders" will be classified as. You should measure your own available time allowance against the following and define yourself broadly as per the categories below:

- Day Trader – typically requires one to sit in front of the screens every single day, for a good few hours. This is your job, you don't have anything else that pays the bills.
- Established Trader – you already have enough capital built up to live off the income you make from trading and can afford to spend as much (or as little) time as you desire dedicated to doing research, looking for trade setups and general "watching the screens".
- Part Time Trader (albeit a temporary plan on your way to trading for a living) – Trading part time generally implies you have other commitments you need to attend to like a formal job, or studying, or playing a professional sport, have a family or small kids, in general anything other than the markets that takes up a lot of your time.

There is a lot of allure to day trading, but very few people truly have the stomach to ride out this style of trading. It's a completely different thing making a profit on a good trade when it happens, than to have the constant reminder that you ABSOLUTELY HAVE TO MAKE A PROFIT else there will be no dinner tonight, or the lights may be turned off, or you can't afford the instalment on the Ferrari next month. This by far is also the riskiest side of the retail market as everyone think they can hack it only to find out that they have reached the end of their money sooner than expected.

My personal opinion is that day trading is something that one morphs into. You don't start out as a day trader. You only get there once your training wheels are off and you have migrated from Part Time to Wealthy.

Novice Day traders reminds me of the saying, "What's the quickest way to trade yourself to a Million Dollars…. Start with Two Million….."

Your time dedication to the markets dictates which type of trading styles you can experiment with. It's is either a driving force or a pushing force. If you have all the time in the world, (and capital) then you can afford to watch the markets the whole day and trade very short time spans.

In fact, it's almost a given that you will. Your time watching the markets shall require your system to regularly kick out trading signals. If you want to see a trader scratching his own eyeballs out from the inside, then have a day trader follow traditional trend trading techniques over a long-term time horizon… if they can't scalp the market they will rather eat a cactus.

On the other hand, if you have a job not related to trading, then the last thing you can afford is to have your trading signals and decision based on a 2-minute chart pattern. You will never have the time to react to these short time spans if you are at work (or alternatively one would have to assume you will never end up doing any work as you'll be constantly on the internet checking and managing your portfolio)

3. UNDERSTAND WHY YOU WANT TO TRADE

By now you will understand the significance and importance of "why you trade".

The "WHY" has a material impact on all your decisions ranging literally from the most basic info like the type of computer, the amount of screens and the speed of the internet access you require, to more complex issues such as your stop loss levels, which in turn has an impact on your deal size and frequency (as well as instrument distribution).

My advice to you is that slow is better. I know that is the WORST message you can give a new trader. In general, trader personalities, especially when starting out are "go big or go home" type. I know, I've been there. No one can become the master of the universe by taking it slow..right?!

The honest truth is that had my mentor given me this advice I probably would not have followed it either! But hey, I made a promise that I will keep telling you guys the stuff exactly as it is, no frills.

Trading at a fast pace without understanding what you do and why you are successful (or not) is a major risk to your future existence as a trader. One need to be able to differentiate whether your results are attributed to randomness or your trading system/style.

In fact, if this book is still available by the time you read this I would want for you to read "Fooled by Randomness" by Nicholas Taleb. It will show you the devastating havoc that randomness can cause and will hopefully give credence to my philosophy of trading for the long term.

You will recall that one of my core fundamental guidelines to you was that your trading should match your personality. So just trust me on this.

4. DEFINE YOUR MARKETS

There are a ton of different markets out there to trade, each with numerous different instruments and securities. More importantly is the fact that some markets react completely different to others, and even the way one would quote these are different.

When starting out the worst thing to do is to go on a shot-gun approach where you literally try and shoot every moving target out there.

Instead I would offer this simple advice. Rather than following a whole bunch of markets, instead find a trading strategy, and then look for signals of that particular trading strategy within a given set of markets or instruments. As an example, you can trade an "inside day" strategy and every night scan for these across say 10 currency pairs. If it does not exist there that night, then pass…. Don't go wondering off into unknown markets looking for this setup.

The reason why is that following a given set number of markets will result in you becoming in tune with those markets. I experienced this first hand. When newcomers joined our trading desk I would often ask them for their views and trading ideas on a range of currency pairs. I would then sit in amusement listening to all their text book answers.

I would then redirect them and ask them for the next two weeks to only follow 4 currencies at max. This small focus, narrowing down the universe of possibilities made a HUGE difference. Suddenly their trading ideas and opinions on the market were supported by fundamental facts, or technical observations to a much deeper depth than when they tried to have an answer on everything. By boiling a cup of water, instead of the ocean, they were able to dramatically improve their in-tune-ness with the market they were focussing on.

5. CREATE YOUR TRADING PLAN

Once you've decided how much time you can dedicate to trading, and once you have defined your markets you wish to focus on, the next step is to explore trading strategies that fits in with this plan.

What you'll find is that certain trading signals and strategies favour certain market conditions and or trading styles. A lot depends on the time one intends to be in a trade, how entry and exit levels are chosen, and to some extent, the frequency with which one intends to trade.

Quite often traders will tend to blend many of these into a single trading style, using one set to determine entry levels, and then perhaps switch to another set to manage the trade and determine exit positions.

For the most part and very, very broadly defined the below are the most common different trading styles and categories in which the various trading signals fits into (loosely arranged from most active to generally least active):

- Scalping
- Day or Intraday Trading
- Technical Trading
- Swing Trading
- Trend Trading
- Fundamental (Macro / Value Trader)
- Investor

The aim would be that once you have defined which category of trader you are (or aim to be), you will then identify all the relevant trading patterns and indicators that are typically applicable or commonly used with that particular style.

6. BECOME AND EXPERT IN THE COMPONENTS OF YOUR TRADING PLAN

Your trading plan's evolution up to now will be a culmination of all the various factors highlighted above. The remaining responsibility on you is to master all the various strategies you intend on using. My advice here remains to limit these to only a few entry and exit techniques.

Gain your familiarity with this while fiercely protecting your trading capital.

When all is said and done, I will show you my "Secret Sauce", and how I use derivative structuring to enhance this process even further!!!

7. IMPLEMENT AND STICK TO YOU PLAN

Strategy can only be measured and altered after you've allowed it a reasonable time to play itself out. The worst thing you can do is to chop and change your trading style.

Find a trading strategy or indicator that works for you, that has some sort of historical relevance (in other words, have been time tested and works), and just stick to it for a while.

Consistency will eventually determine your success. If you can't stick to your plan you will never truly be able to isolate areas of concern. In other words, you need to be able to establish whether your trading strategy failed or did you fail the strategy?… this can only be measured over time.

8. ENJOY THE RIDE

Lastly, always remember that you're here, on this trading journey, because you want to be, in fact you chose to be. Why do something that makes you unhappy or unfulfilled. Enjoy Life

Chapter 4 - Different Trading Styles

There are various different types of trading styles, and matching your own personality to the one most suitable is critical to your own trading longevity.

Certain types of trading signals and strategies definitely favour certain market conditions and more specifically, trading styles. A lot depends on the time one intends to be in a trade, how entry and exit levels are chosen, and to some extent, the frequency with which one intends to trade.

Quite often traders will tend to blend many of these signals and choices into a single trading style, using one set to determine entry levels, and then perhaps switch to another set to manage the position during the life of a trade and eventually determining the exit point.

For the most part and very, very broadly defined the below list are the most common trading categories in which the various trading signals fit into (arranged from most active to generally least active):

- Scalping
- Day or Intraday Trading
- Technical Trading
- Swing Trading
- Trend Trading
- Fundamental (Macro / Value Trader)
- Investor

It is important for you to differentiate which type of trader you are and in which general category you fit.

The aim would be that once you have defined which category of trader you are (or aim to be), you will then identify all the relevant trading patterns and indicators that are typically applicable or commonly used with that particular style.

SCALPING

Scalping is by far the most time demanding trading style out there. You literally have to be glued to your screen the entire trading session. The aim with scalping is to pick up a whole bunch of small movements moving in and out of a trade regardless of the direction, with only a few profit pips made at a time as the main goal. It is not uncommon for a scalper to be in a trade literally for a few minutes only.

One can imagine that this style has the potential to yield a massive return. In fact, annualised returns measured on a per trade basis usually are astronomical. The problem however is that very few traders actually survive this style of trading. It is extremely demanding and probably one of the hardest trading styles to get used to. Having said that though, ironically enough this is also the style of trading that many novice traders are drawn to, only to yield disastrous results.

If ever there was a style that demands you keep to the trading rules, then this style takes the prize. No room is left for interpretation, when you see a signal you react, plain and simple.

Scalpers usually trade on a very short time frame chart pattern, like 1, 2 or 5 minute chart intervals. Furthermore a definitive “must have” for this style of trading is what is commonly referred to as a 1-click trading. This refers to where your broker system on which you execute trades let you enter a trade with just 1 click. Usually one would enter a trade, then you need to enter an amount and then you submit the button, and then another confirmation message appears to ask if you really want to trade, and then only once you press the submit button is the trade sent through for processing. You can see how this process would be tedious for a scalper, for them they usually set a standard contract value and a “rapid fire” setting allowing them to trade by just clicking on the buy or sell button once.

DAY OR INTRADAY TRADING

A day trader or intraday trader generally holds positions for a relatively short period of time. The key difference between the two is that positions for an intraday trader are opened and closed within a single day’s trading session. Most often their trading limits/style does not allow to run positions over night as they would prefer to not have exposure to the market at times, they are not there to watch it. A day trader therefor most often ends up being an intraday trader, with the exception that if a position signal is still supported, they will run the position over night.

Though similar to scalping in the sense that these traders use very short time intervals, a day trader generally aims to catch a slightly longer ride on the trend than a scalper. As an example, they may in fact Swing trade a 1-hour chart, something that is generally expected for longer term momentum traders. By them reducing the time frame over which the swing signals are produced one can say it’s like trend trading on steroids ☺

TECHNICAL TRADING

Technical trading refers to a style of trading where one’s decision to enter or exit any particular trade is not based on the relative performance / strength of an underlying asset or instrument itself, but instead directly as a result of a chart formation and the expectation of price action around this formation.

In other words, where one does not buy a stock because the company is doing fantastically well, but instead that the price movement created a specific chart pattern which can be explored. Thus, more a case of trying to profit from the herd mentality of trading. For this reason technical analysis is often referred to as a self-fulfilling prophesy, especially in instruments that are widely traded with a lot of liquidity.

A Technical Trader therefor will purely use technical signals to analyse which securities to trade, to decide on a particular entry point, dictating how they will manage the position during the life of the trade as well as at which point they will exit (or where to place their stop loss points during the trade). They typically exit positions when the chart pattern (or technical signal) is complete and not based on a set time frame (as would be the case with a day trader as an example).

For the most part, the bulk of the trading styles mentioned here are fundamentally, and at their core technical traders, with the key difference being expressing their views across different time frames. So by this definition it is not uncommon for technical analysis to be included in all forms of trading (from Scalping to Swing Trading).

SWING TRADING & TREND (POSITION) TRADING

I group these two styles together as there really are not much fundamental difference between these two styles of trading. They both employ the same type of analysis to identify trades and entry levels with the only remarkable difference being on the way these traders exit positions.

For this reason, swing trading most often have shorter trading periods than Trend Traders in general given that a Trend Trader's aim is to catch huge long-term trends scaling into positions and often only exiting after many weeks, months or sometimes even years, when the overall direction of the major trend has changed.

Swing traders on the other hand will exit positions when interim stop loss levels are triggered, or a profit target is reached.

So in practice one would see a Swing Trader trade the exact same trend as the Trend Trader, however moving in and out of the trend many times more often than the Trend Trader does. Realise of course that there are no hard and fast rules as all this depends on the time frame of the charts each would use (hence me grouping these two categories into one).

This style of trading is where we will spend the most of our time in. In fact it's probably the most popular style for anyone who works full time.

With the aim of this style of trading being to catch large movements (trends), there really is no reason to be glued to your screen the whole time, and quite often most analysis take place after the market has already closed. The frequency of market analysis can also be far less demanding ranging from daily or a weekly basis only.

I refer to this style as a "trade as you go" mentality. Trading is an enjoyment factor not a punitive factor so why add additional stress to your day if you don't have to.

FUNDAMENTAL (MACRO TRADING) AND INVESTING

I include these styles of trading purely for reference.

Don’t get me wrong, Fundamental Analysis remains an imperative style of analysis that works wonders for a specific sub-section of instruments / securities (especially in stocks and bonds or where fundamental economic policy shifts occur in the case of currencies).

This however I will leave to discuss in detail in the general finance section of this website as it has limited use for the type of trading we will embark on for now.

Chapter 5 - Understanding Risk

Probabilities and chance forms an integral part of our everyday existence. Practically every and anything in life can be calculated and expressed in terms of probability, and subsequently by extrapolating its associated risk.

- The chance of it raining tomorrow
- The chances of getting a Red rental car
- The likelihood of being assigned a window seat on an airplane
- The probability of winning the lottery
- The likelihood of getting lost while walking in the woods

What is Risk?

Imagine you're on vacation in Vegas and as you are about to walk into the Casino, you bump in to your two buddies. You ask them how much money they were able to walk away with after gambling the whole day.

Buddy 1 responds that he has $500 in his pocket, and Buddy 2 says he has $3,000… so who had the best luck at the tables do you think?

It's very easy to fall into the trap thinking that it must obviously be Buddy 2 with $3,000. However, without asking the following two questions one really won't be able to properly say this with complete confidence:

- Question 1 – How much money did you have, going into the Casino?
- Question 2 – How much did you expect to win or lose?

You see, the problem with looking at results only is that one does not take into account the fundamental principles of risk management which is comparing the Actual Outcome to the Expected Outcome, and measuring this extent of this difference. Furthermore one also has to consider the frequency with which this difference may occur.

One almost intuitively leans towards just observing the actual outcome of profit and loss and then make a judgement call, trying to determine who performed best.

Imagine Buddy 1 started at the casino with $800 (ending with $500), and Buddy 2 with $10,000 (ending with $3,000). How would you view their results now?

Asking the Right Questions

When it comes to trading, we don't just aim to compare the absolute outcome of our respective trading strategy, but also its relative safety.

In other words, relating this back to the question about our buddies in Vegas, we would not have just asked "How much did you win or lose?", we would also want to try and figure out who was the "safest" gambler. In other words, who took the least amount of risk in relation to the possible reward. So the follow up question of "What did you expect to win or lose?" becomes equally relevant.

If Buddy 1 was willing and expecting to lose up to $300 of his starting capital then, even though he still would not be happy with his result, at minimum he would be able to live with it given that it was in line with his own expectations.

Buddy 2 on the other hand, expected to only lose up to $2,000 of his cash, but ended up losing $7,000! More than three times what he expected!

The inference one can draw from this is that Buddy 2 was in all likelihood the "go-big-or-go-home" type of risky gambler! Any large variance (positive or negative) between what was expected and what actually occurred points to the relative risk associated with that event. A small difference implies less risk and a large one that this event is risky.

Measuring the Unmeasurable

It is natural to now sit and wonder, how does one measure risk properly then?

Remember for traders, this can be simplified by measuring the expected amount you stand to win or lose against actual trade results. For losses, this can be managed via the use of various stop loss strategies.

In doing so you effectively manage both the max loss value but also the difference (variance) in the actual loss that occurred relative to how much you would have expected to lose under those conditions. One has to also consider that slippage, when exiting on a stop loss, contributes to a hard-stop not executed at the expected value, but more on that at a later stage.

Note, in an effort to avoid confusion, I am purposefully excluding profit takes from this discussion for now as this needs to be considered while keeping in mind a concept of "letting your profits run", and under those circumstances your actual profit realized could be materially different to expected profit. However I would argue that under those conditions this variance is not considered a risk as one had the opportunity to exit at the original expected profit target.

For purposes of a broader understanding of risk, I thought it appropriate to take this example a little further and explore how risk typically gets measured in real life practical examples (non-trading related).

Wanna Bet?

Imagine I give you $100 to bet on any one of the following two golfers, who would you bet on?

You'll agree that at this point you have no real information on either golfer. So technically any bet you make at this stage will be risky!

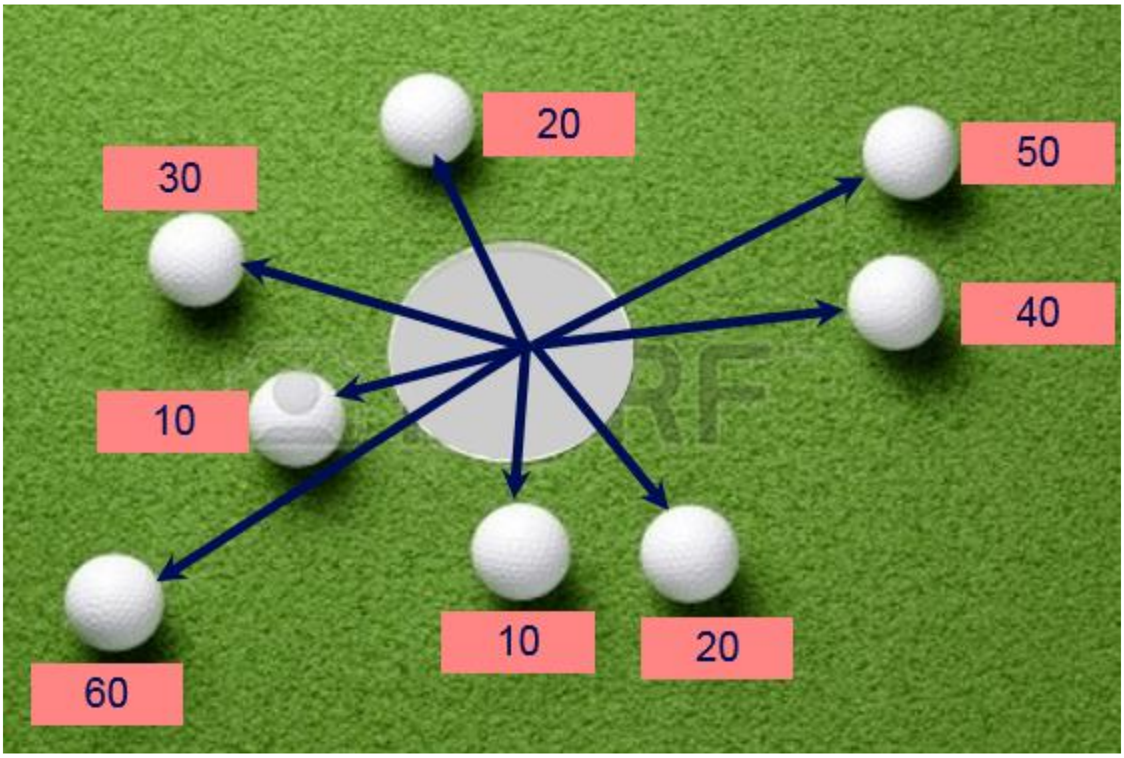
Therefore, one way in which to reduce your risk is to aim to come up with some way in which one can accurately compare one to the other.

In this instance, the only real way to evaluate their individual ability is to give each golfer a putter and ask them to try and sink a ball while standing 20 meters (about 22 yards) from the hole.

- Let's assume it is a flat surface i.e. no gradients to influence the ball
- Let's start by providing each golfer with 8 balls to put

Defining the Measurable Outcomes

In order to compare the golfers, we'll measure each one by how well they can put. This can be done by measuring the distance each of the 8 balls from the hole, and then assigning a value to each as illustrated below



- A ball that goes into the hole has a distance of 0
- A ball putted and stopping 50cm from the hole has a distance of 50

Results after 8 Balls

Let's see if we can establish some more clarity by looking at the results of each golfer after having putted 8 balls towards the hole.

Results after 8 putts:

GOLFER A

DISTANCE	BALLS
10	2
20	2
30	1
40	1
50	1
60	1

GOLFER B

DISTANCE	BALLS
10	2
20	4
30	-
40	1
50	1
60	-

Let's look at how ***Golfer A*** did with 8 balls

- What does this now tell us about this golfer's skills?
- Can we say (with confidence) that this golfer is a pro or a novice?
- On average how accurate is this golfer? Do we know?
- Are you willing to place a bet on Golfer A as yet?

The problem we have is that with only 8 balls, we really cannot evaluate these golfers as the "sample size" of the experiment is just too small to reach definitive conclusions.

How do we improve our analysis?

Increase the Sample Size

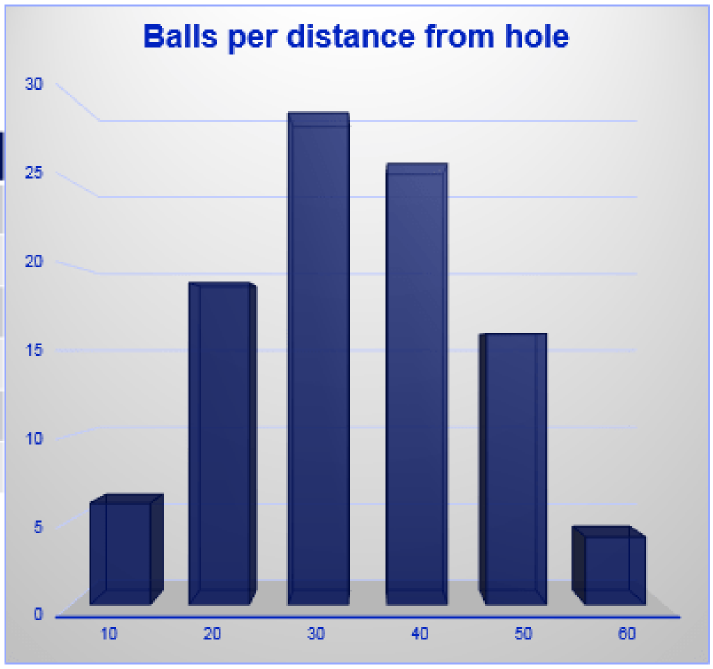
By letting each golfer now hit 100 balls, instead of only 8 we should be able to evaluate their results with a bit more certainty.

Let's again look at the results from Golfer A and see if we can make some sense out of it.

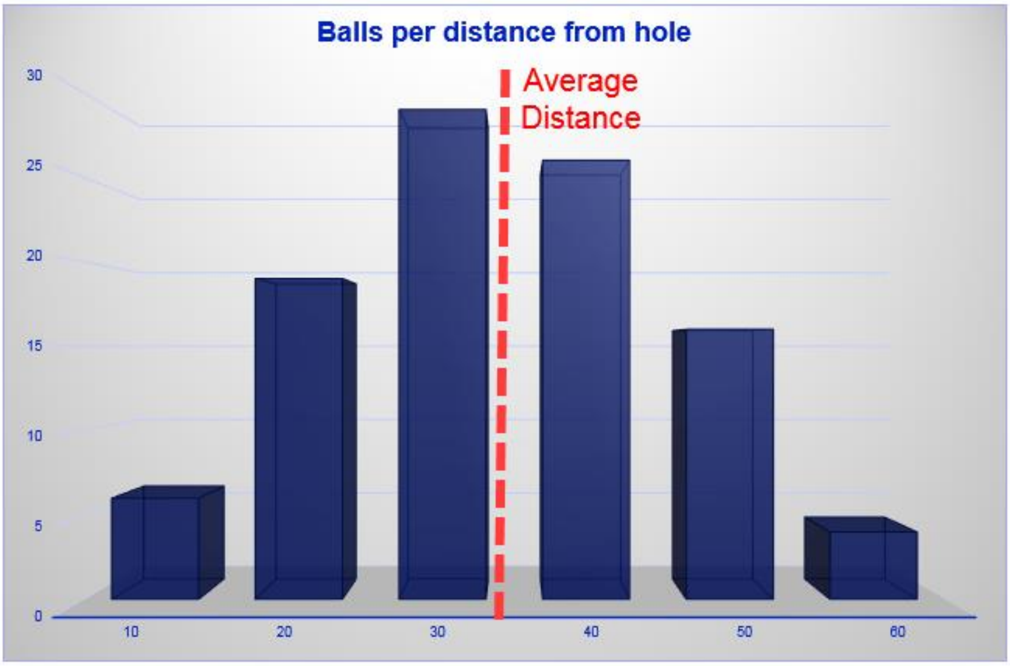
By grouping the balls in various "distance buckets" we should be able to analyse this golfer a little more thoroughly.

- Golfer A - Results after 100 puts:

DISTANCE	BALLS
10	6
20	19
30	29
40	26
50	16
60	4



Simple math of adding all the distances together and dividing it by the number of balls putted allows us to determine what the average distance is that Golfer A's balls landed from the hole.

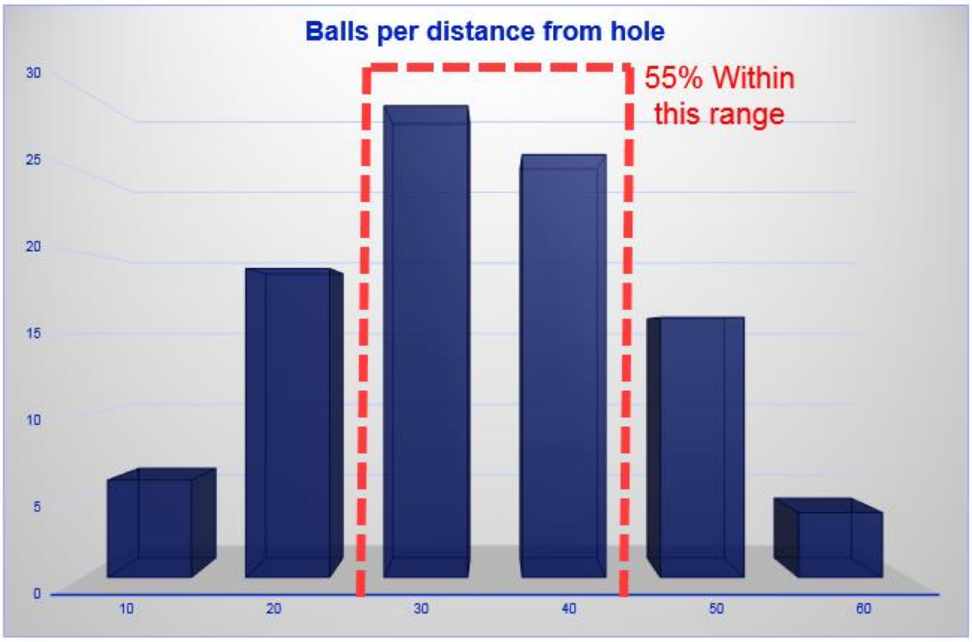


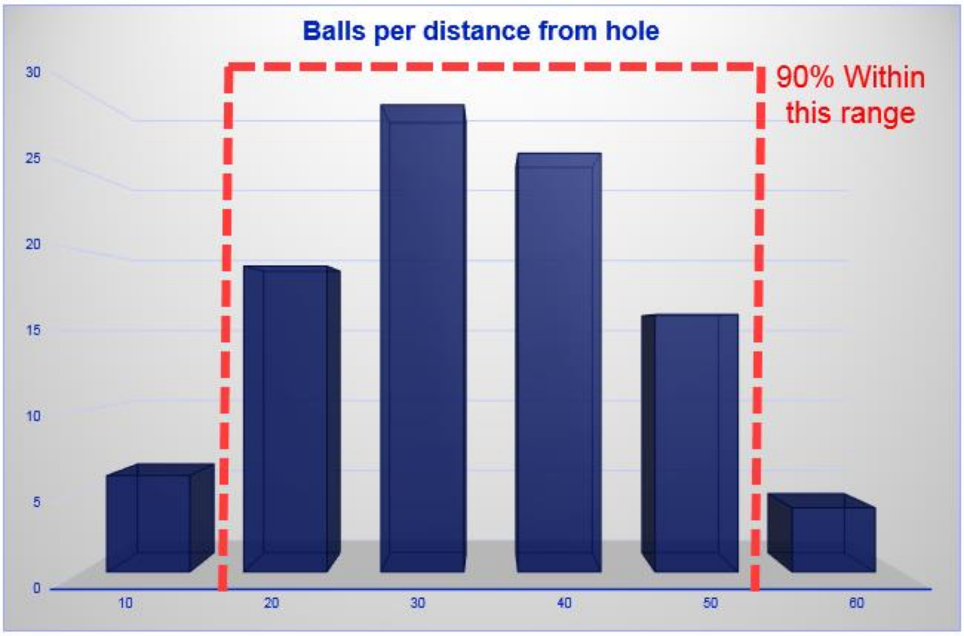
The problem is that Average Distance on its own tells us little about this particular golfer's consistency.

A reminder that risk is measured by the variance of expected return to the actual return. So in this example we can say, the greater the number of balls this golfer can put as close as possible to this average distance, the more stable the golfer, and the more reliable this golfer shall be to bet on.

What's the Variance?

The next step for us would be to determine how many balls ended up being relative close to Golfer A's average.





Interpretation of the analysis

Results after **100** puts:

GOLFER A

DISTANCE	BALLS
10	6
20	19
30	29
40	26
50	16
60	4

Average = 33.9

55% of balls between 30 and 40

90% of balls between 20 and 50

GOLFER B

DISTANCE	BALLS
2	7
8	20
12	36
40	14
70	20
80	3

Average = 28.0

50% of balls between 12 and 40

90% of balls between 8 and 70

Who is the better putter?

By having all this info we are able to now make a more informed decision. The results shows that Golfer A on average hits 90% of the golf balls to land in a range of between 20 – 50cm from the hole, a 30cm distribution (variance) around the hole.

Golfer B on the other hand has 90% of the golf balls land in a range of 8 – 70cm, resulting in a distribution of 62cm around the hole, roughly double that of Golfer A.

So if I was a bettin' man – my money would be on Golfer A

Conclusion

One can summarize Risk as follows:

Risk is the extent to which the actual outcome deviates from the expected outcome

The greater this difference (also referred to as variance) – the greater the risk

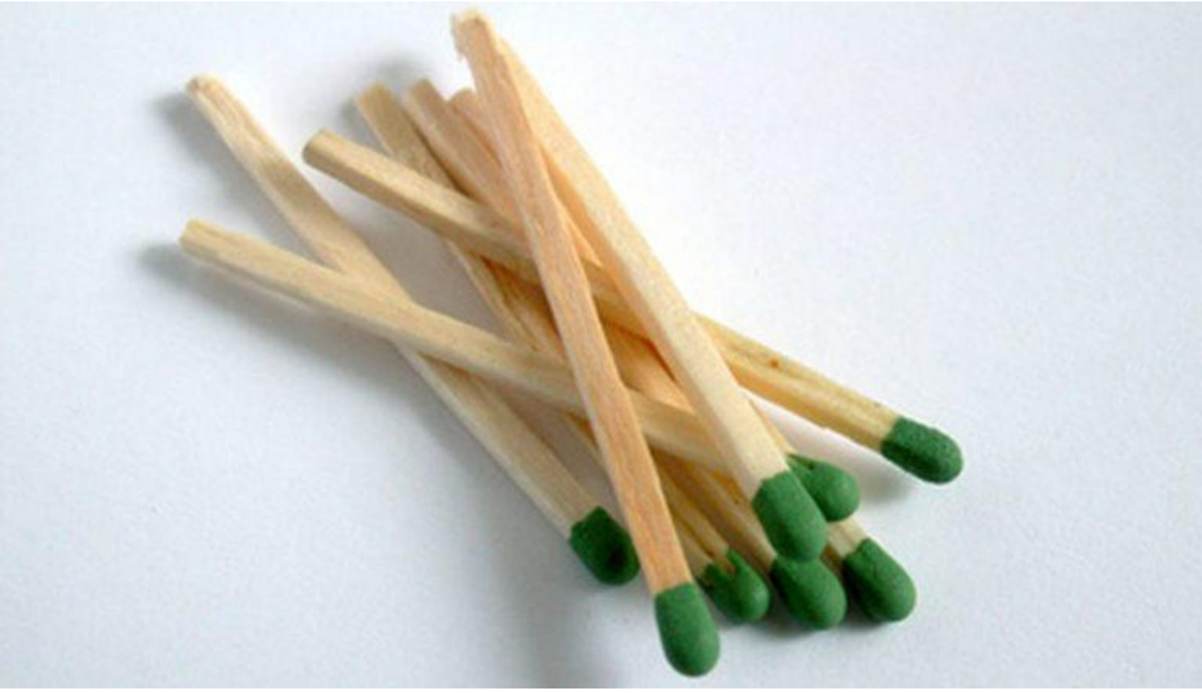
Chapter 6 - PRESERVATION OF TRADING CAPITAL

This is undoubtedly one of the most important lessons to learn!!

Preservation of capital will have a direct influence over how you are to manage you trading, everything from style, position size, types of securities you choose to trade, all of which has only one single purpose in mind, to keep you in the game for as long as possible.

A State of Mind

Think of it this way, if you go camping for the weekend and you have five match sticks in your match box, one would have a sense of comfort knowing that you should be able to make a fire for each of the two nights you intent to spend outdoors. You even have a few matches to spare if something unexpected happens and you can't start a fire on the first try.



Now, let's change the dynamics slightly, what if I tell you that you still only have five matches available, however a thunder storm caused massive damage to all the roads leading out of the camp site. Trees have fallen over, completely barricading the roads and no one can go in or out of the camp site. You are stuck there for at least a week, if not longer while the rescue teams are working on clearing the storm debris.

Do you agree that this introduction of the unknown amount of time has brought with it a new complication?

It causes you to think differently about your matches doesn't it?

All of a sudden your focus shifts from not having to worry about how to start a fire every night, to "how can I preserve my fire without burning through my matches". All of a sudden your focus shifts to keeping your fire from burning out – the longer you can make your matches last, the longer you'll be able to wait out the situation before being able to return home.

Isn't it amazing how just this one factor would change your way of thinking? This is exactly the same when it comes to trading, which I'll show you later on.

Need to be in it for the long haul

Trading is not a get rich quick scheme. It takes dedication, patience and consistency to be a success. Equally important is the knowledge that experiencing losing trades is part and partial of the process.

Planning on this fact, even better yet, expecting that many of your trades will turn out to be losers is a key component to a winning strategy.

Put differently, if you are in the frame of mind that losing trades are common and part and partial to trading, it will help you on two fronts:

- You won't be hung-up on any one particular trade's outcome (successful or not)
- You'll naturally ensure that your losses are kept small as and when they occur

This small, yet key mental shift does wonders for your trading personality. However, as with everything in trading, cannot just be viewed in isolation.

I have found that many retail traders profess to have a thorough understanding of basic Risk Management techniques, yet their main focus is only to guard their capital against any one single, large and unforeseen event.

These retail traders often completely overlook the most damaging aspect of them all, consistently losing small amounts without ever putting a stop to the process. They continue to lose small amounts, sticking to the argument that as long as I don't lose more than a certain % on any single trade all will be fine.

Though true in its fundamental form, it forms part of a three pronged strategy and is a key component that we will always make use of. The % Risk rule however cannot be viewed in isolation. If you continue to lose, trade after trade, at some point you will run out of capital.

Draw-Down Limits – The Tool of Professionals

What is a Drawdown Limit? In its most basic form it is a line in the sand that you draw on the maximum loss you are willing to withstand on your trading capital so that when triggered, you force yourself to take a break, reassess the situation, correct any obvious flaws in your strategy and dial down trading risk to the bare minimum.

Why is it so vitally important?

If you experience a loss of your trading capital, the direct effect is that you now have less cash to work with in order to trade. The second obstacle is that from this limited capital base one now have to bag more winning trades to an extend that you can recover your lost funds and hopefully return to the original capital amount you've started off with.

If you have trading capital of $700, after an initial loss of 30% of your capital, and you want to trade your way back to $1,000 (assuming this was your initial capital) you would require the make a 43% return from your current trading activities.

This is quite a big ask, even from professionals!

An increase of 100% on the current Capital only brings you back to where you've started from

20% Max Draw Down Limit

In order to give yourself a fighting chance when things go belly-up, we want to try and limit the max draw down in such a way that if it happens, the return required to get back to square one is not astronomical, and not out of reach given our particular style of trading and risk taking.

I have found that one can work your way up to a 25% return with relative ease (especially when using yield enhancing structures). Keeping in mind that trading is a long-term endeavour, even if you can't make 25% in one year, you'll easily manage to recover shortly thereafter.

With this in mind, I recommend a Max Draw Down limit of not more than 20%.

Once you hit this limit, take a break, take a few weeks off from trading to clear your head and analyse your trading up to that point. Try to identify what went wrong. Did your system fail, or did you fail your system — there's a huge difference between these two!

Trust me, you can't trade with a negative cloud hanging over your head, so this break is often a much needed tool in the prevention of portfolio self-destruction. Losing 20% requires you to make 25% to get back to your original capital amount and will do wonders for your trading psyche once achieved.

Importance of Protecting Newly Gained Capital

Professional traders understand the importance of preservation of capital, ALL CAPITAL, not just the amount you started with.

In fact, along with managing one's emotions, I would say that this point is by far the most important aspect monitored throughout the entire trading process.

The truth remains that you can only trade if you have capital to trade with and once that is gone, you're outa there.

A major benefit of the Max Draw Down rule is that it also ensures that you protect any new growth in your portfolio, in other words, newly acquired capital.

Trust me, it's worth its weight in gold to take a page out of the professional's trading handbook on this!!

The last thing you want to happen is to start off with $1,000, trade yourself all the way up to $200,000 only to lose all on a down streak ending up with only $50,000 again.

In isolation having turned $1,000 into $50,000 is great, but not when you considered you've turned $200,000 into $50,000, losing 75% of the trading capital you had available at one point.

The trick is to bank all your gains and to adjust your Draw Down Limit to an amount representing 20% lower than the highest level your trading capital has ever been up to that point (often referred to as the High Water Mark by professionals)

It's a simple rule, be sure to follow it!!

Chapter 7 – How much to risk per trade

A discussion on risk, cannot be complete without evaluating one of the most commonly used techniques traders use to manage and preserve their capital – The 1% Risk rule.

The problem however is that one's emotions relates to risk in an abstract manner.

Many traders when quizzed will admit that their expectations of how much risk they can tolerate often is far different to how they actually tolerate risk once in a trade.

For this reason, one cannot assume that the 1% Rule applies equally to all.

The aim would be to focus on determining the most appropriate % that fits your own trading style and personal risk tolerance. For an in-depth understanding and explanation of the basic concept behind this rule, I recommend you read the chapter on Possibility vs Probability.

The Rule's Impact

The sole aim of this rule is to manage three things:

- Your own emotions
- Your trading capital
- Your longevity as a trader

By limiting the amount you stand to lose on any one particular trade, not only will you feel less intimidated to trade, but you will also be far less hung-up on the outcome of any particular trade.

Furthermore, by limiting the amount you lose per trade, you ensure that your capital cannot be wiped out by any one single trade, but more importantly, that as your balance on your trading capital systematically reduces (as a result of small individual losses) it also provides you with the opportunity to slam on the breaks and stop all trading (or at minimum reduce risk) allowing you the much required room to re-look the situation.

Determining the Appropriate Risk

One can determine an appropriate % to risk by taking into account the following

- Your Risk/Reward Ratio
- Your Historical Win Rate
- The Max Draw Down Level
- How many instruments you trade at a given time (open positions)
- The frequency at which you trade

I threw that last two points in the mix for the sole reason that traders often are masters at only taking 1% risk per trade, but then end up having 20 trades open at any one point in time (I'm ignoring correlation and diversification trades for now). This is a recipe for disaster.

An unexpected market blow-out against your positions will result in a loss far greater on that single point in time than what was planned on, or certainly what one aims to prevent by applying this rule in the first place.

Risk Reward Ratio

This ratio is of critical importance as the idea behind trading is that, given that you expect many of your trades not to work out, that you would want to ensure your losses are kept smaller than your winners.

As such, it is very common for a trade to be evaluated in relation to its potential risk (profit) relative to the amount you stand to lose if your stop loss is triggered (Risk).

It is important to note that different types of traders may apply the RRR differently, as an example, Trend Traders may use the RRR during a trade and not necessarily at inception thereof. You can read more on How Trend Traders use RRR, but for now I won't go into any specific detail about any trading set-up, indicator or strategy, but instead you just assume you get a signal that points to a trade with a possible up-side of 200 points (i.e. your profit target were you most likely will exit the trade, or once there will evaluate its potential to move further in your favour).

Imagine further that in order to take this trade, your stop loss level needs to be placed 150 points away from the market (usually in order to allow for the pattern to unfold, or for normal market volatility to trade freely without the risk of cutting you from the position prematurely).

The Risk Reward Ratio can then be calculated as the expected gain, expressed as a percentage of the possible loss you stand to make, so in our example 200 / 150 for a RRR of 1.33

Thus, for every $1 we stand to lose on this trade (risk), we will stand a chance of gaining $1.33

Once this RRR is known, you can then compare this expected return to how often you win when you trade and work out if it's worth your while to take the trade or not. The aim being to strike a balance of using the RRR in combination with your win/loss rate.

The reason for this is that if you lose 9 out of 10 trades you take, it's clear to see that a RRR of 1.33 won't be enough, possibly losing $9 only to make $1.33 when you are successful is not placing the odds in your favour.

Historical Win Rate

Simply put, your Win Rate refers to how often your trades end up with gains, relative to trades ending up with losses.

If you consistently follow a specific way of trading or a strategy where you consistently react the same to the signals / setups of the strategy (entry and exit techniques) then it's very easy to evaluate the success rate of this strategy. This is often best done by keeping a proper Trading Journal.

Using our example above, if you had a win rate of 8/10 trades, you will in fact be quite comfortable with a RRR of only 1.33 knowing that the possible loss of $2 will be more than compensated by the possible $10.64 you can achieve from the 8 successful trades (8 x 1.33 = 10.64).

Your minimum win rate can thus be determined by using the RRR you expect as follows:

Minimum Win Rate = 1 / (1+RRR)

In our example, 1/(1+1.33) = 43%

So out of 100 trades, we require a minimum of 43 trades to end up as winners, generating $57.19 (43 x 1.33) to compensate for the 57 losing trades on which we stand to lose -$57 ($1 on each trade).

A further interpretation of this could be that if you know what your own historical win rate is on a particular way of trading then you will be able to calculate the minimum required return (or Risk/Reward) required on any one particular trade.

This then will be a way to determine if a trade can be taken or not. Let's assume we had an historical win rate of 25% on a strategy. The trade in question has a RRR of 2.25 which appears to be nice and profitable. Let's see if we can take the trade…

Min RRR = (1/Win Rate) – 1

Min RRR = (1/0.25)-1

Min RRR = 3 : 1

In this example, with a win rate of 25% we will not be able to take this trade as it requires us to have a minimum RRR of 3.

I have put together a RRR vs Win Rate calculator for you, as can be seen below. This will make life much easier to see all these pricing dynamics in action.

EXPECTED DEAL DYNAMICS

Current Historical Win Rate	25%	(From Trade Journal)

CAN DEAL BE DONE ??	
No - Trade does NOT meet minimum Requirements	
Minimum Win Rate Required	52%
Or, Minimum RRR needs to be	3.00

		Profit	Risk
Deal Entry Price	1.6500		
Projected T/P	1.2225	0.4275	
Slipped Stop	1.1900		0.4600
RISK REWARD RATIO			0.9293

CHANGE VALUES IN BLUE ONLY

** [DOWNLOAD YOUR FREE COPY OF THIS RISK CALCULATOR HERE]

Max Draw-Down Percentage (%)

Knowing how much we stand to lose on any one trade given expected RRR combined with the Win/Loss ratio will allow us to extrapolate how many concurrent losing trades our trading capital can absorb before it hits the Max Draw Down limit on our trading capital.

The reason this is taken into account is due to the fact that even with the best intentions, the sequence of your Win/Loss trades are not always conveniently spaced, and one has to plan for the possibility of consecutive losing trades.

What Is a Safe % to Risk?

If any of the above concepts sound confusing, don't worry about it that much for now as I will show you exactly how we incorporate those once we physically start trading. Trust me that the penny will drop on this, and all this will make sense.

For now, just trust me when saying that in my experience the sweet-spot for those starting out usually sits between 1% to 2.5% of available capital (also somewhat dependent on how much capital you are able to start off with). For seasoned traders they may sometimes tip the scales at around 3 – 3.5% per trade, but no one really goes much above these levels.

In order to explain why 1% is most preferred to start off with, I thought to show you a quick example. I have created a simulation of various possible outcomes of betting on the result (heads or tails) when randomly flipping a coin 1,000 times.

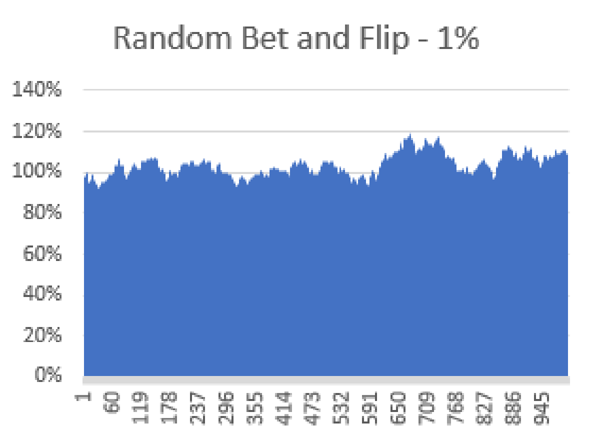
I am sharing this excel sheet with you (which you can download here), for you to play around with.

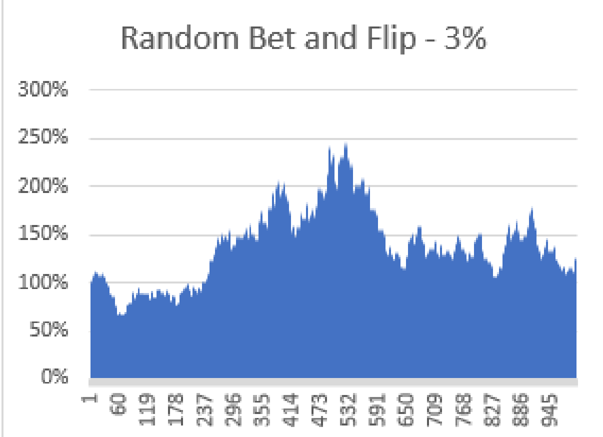
This sheet shows you how random outcomes of flipping a coin, affects available capital based on a predetermined fixed % of capital risked per flip.

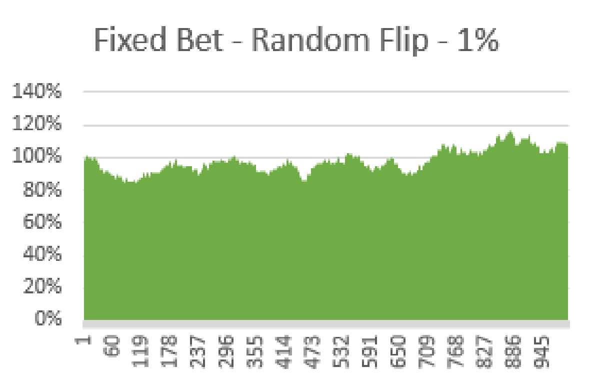
I further went as far as comparing the outcomes based on two scenarios. The one scenario is based on flipping the coin 1,000 times, and every time randomly selecting either heads or tails as your bet. The results are compared to flipping it 1,000 times but for every flip your bet always remains the same and for all the flips s placed on the outcome always being “heads”.

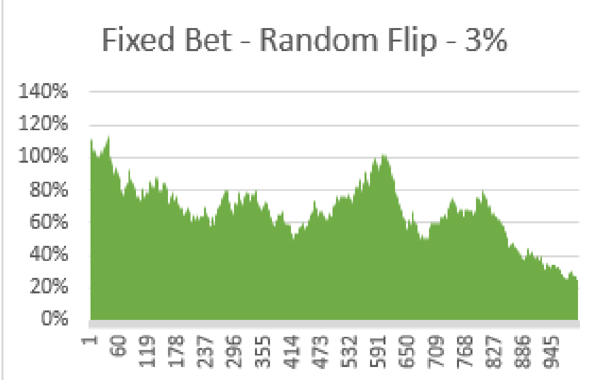
It is important to remind you that given that these outcomes are completely random, every time you run the simulation you will observe different possible outcomes (i.e. the graphs will look different). However, what you will consistently find is that a visual observation of the 1,000 possible outcomes clearly shows a relatively smoother distribution of possible outcomes at 1% risk.

The simulation runs across four different risk parameters being 1%, 3%, 5% and 10%. You will note that regardless of the number of times you run the simulation that without fail, the possible distribution of outcomes shows a material change with each subsequent jump in % risk allocated.



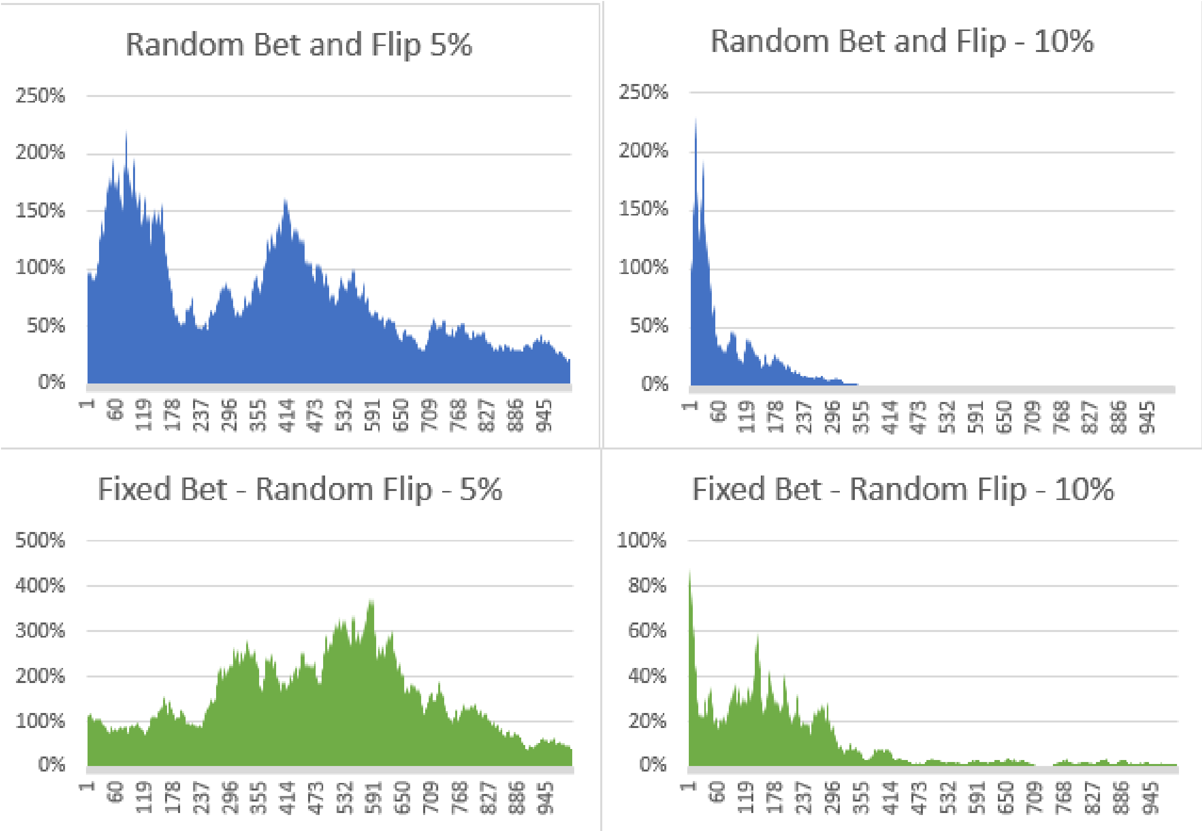






What is strikingly obvious is that regardless of keeping the direction of the bet constant or changing from heads to tails randomly with every flip, risking 1% on both simulations shows far less variance in the outcomes than even marginally increasing the risk to 3% per trade.

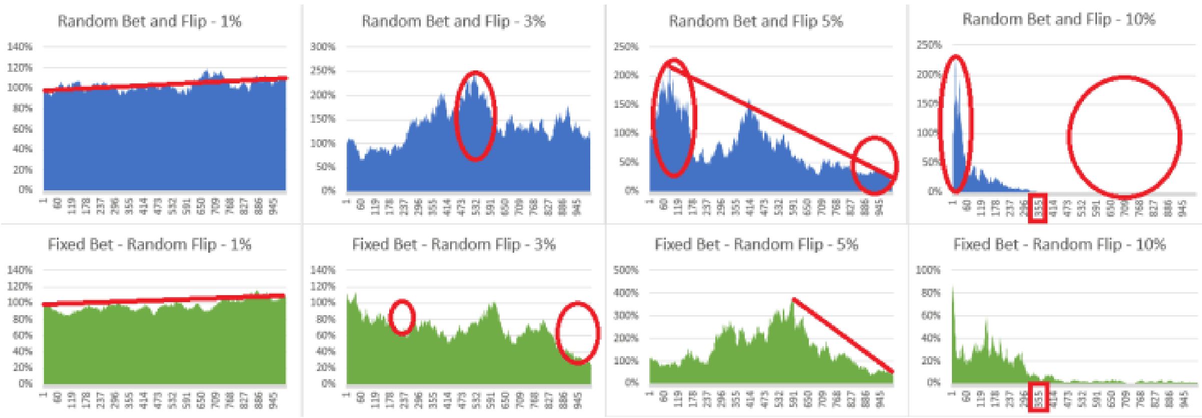
Look what happens if you risk 5% or even 10%



Summary

So in the end, with the aim being to achieve some level of consistency in your trading, all while allowing yourself and your trading strategy a fair chance to fight against the evil forces of the market, a max risk of 1% appears to be the winner.

Seen below, at 1% risk the slope of possible returns are far more palatable than the big, isolated results (albeit positive or negative)



In the end, the increase in possible rewards just does not justify the associated increase of risk of being carried out on a stretcher and losing all your trading capital.

Chapter 8 - A Trend Trader's Take on Risk Reward Ratio (RRR)

In the chapter on How Much to Risk per Trade I went into the importance of having set measures in place to assist in preserving as much of your trading capital as possible. One such measure was to never risk more than a pre-determined % of your trading capital, in addition it also covered how traders should consider using the Risk Reward Ratio along with their own unique Historical Win Rate.

In this chapter I wish to take the concept of Risk Reward Ratio a little further, and in particular, highlight how to apply this measure when trend trading.

The general aim when using all these risk measures are as follows:

- Limit the impact and effects of any one single trade to your overall portfolio
- Stack your trading edges in your favour so as to only take trades, or set targets that complies with pre-determined and qualifying criteria
- Prevent ones trading capital from slowly but surely dwindling away

As a trend trader, the use of a Risk Reward Ratio becomes a bit more subjective, and more often takes on a function of identifying or an estimation of the "Minimum Required Return" of a trade, …let me explain.

Given that part of trading is the expectation that many of the trades taken will not work out, a traditional RRR is of critical importance. This along with your own unique Historical Win Rate, which when used together aims to determine which trades are good to take and which aren't based on their ability to generate enough profit to counter the effect of the cumulative and expected losses taken.

Simply put, if for every $1 you risk, you expect a return of $1.50, this trade will have an RRR of 1.50, this in turn requires a win rate of 40% in order for your particular "trading style" to break even as can be seen below.

Trade	WIN	LOSE
1		-1.00
2	1.50	
3		-1.00
4		-1.00
5	1.50	
6	1.50	
7		-1.00
8	1.50	
9		-1.00
10		-1.00
TOTAL	6.00	-6.00

Trade with RRR of 1.50

Win Rate Required 40% (4 out of 10)

It logically follows then that if you can improve on the 40% win rate, or alternatively obtain a better RRR than 1.50, then only will your strategy be profitable (more detail on this can be found in the chapter on How Much To Risk Per Trade).

RRR and Technical Analysis

There are many technical indicators and set-ups where one can predetermine, with relative accuracy, the expected profit target of an anticipated trade right at inception. An example of this is via the use of triangle set-ups or Fibonacci retracement levels etc.

This gets a bit trickier for Trend Traders though…..

The aim of trend trading is to catch as much of the trend as possible, in other words to ride it as long as the trade remains intact.

A trend trader therefor, at inception of a trade, would not have such clear profit targets as could be expected with the use of some other technical set-ups, and therefore the ability to determine the trade's RRR becomes a bit tricky.

This "profit target" becomes even more vague when considering that many trend traders will take a longer term view on the change seen in the trend (like a break out strategy or Moving Average etc.) and would want to be in the trade for as long as it remains viable to do so.

It therefor is practically impossible for a trend trader to know the expected extent to which the trade can run.

At best, the one thing a trend trader can control at inception is the stop loss level which will be applied to the trade. This ability to set the stop loss level remains of crucial importance as part of a solid, general risk management strategy and can be done in line with the "% Risk of Capital". Thus at least you'll have one of your bases covered.

A Major Challenge for Trend Traders

Once in a trade, one of the biggest temptation for a trend trader is to bank profits on a trade that is going well.

In principal one can argue that this is not a bad thing, however the reality is that as a trader you really do need all the help you can get. So if I trade is making profits, you should try and maximise the profits on that trade, while the going is good.

You really do need those trades that every now-and-then banks a "10 x Risk", in order to give yourself a nice cushion. This is far easier than always trading right at the brink of your RRR stats.

While on this subject, let me also clear up one of the most common misconceptions you'll often hear from many traders (even those proclaiming to be professionals).

> *"One can never go broke taking a profit"*
>
> General Market Quote

This is not entirely correct, and here's why….

Trade	WIN	LOSE
1		-1.00
2	1.30	
3		-1.00
4		-1.00
5	1.24	
6	1.15	
7		-1.00
8	1.55	
9		-1.00
10		-1.00
TOTAL	5.24	-6.00
	Net Loss	-0.76

Win Ratio is still 40%

Taking profits too early results in gradual deterioration of your trading capital

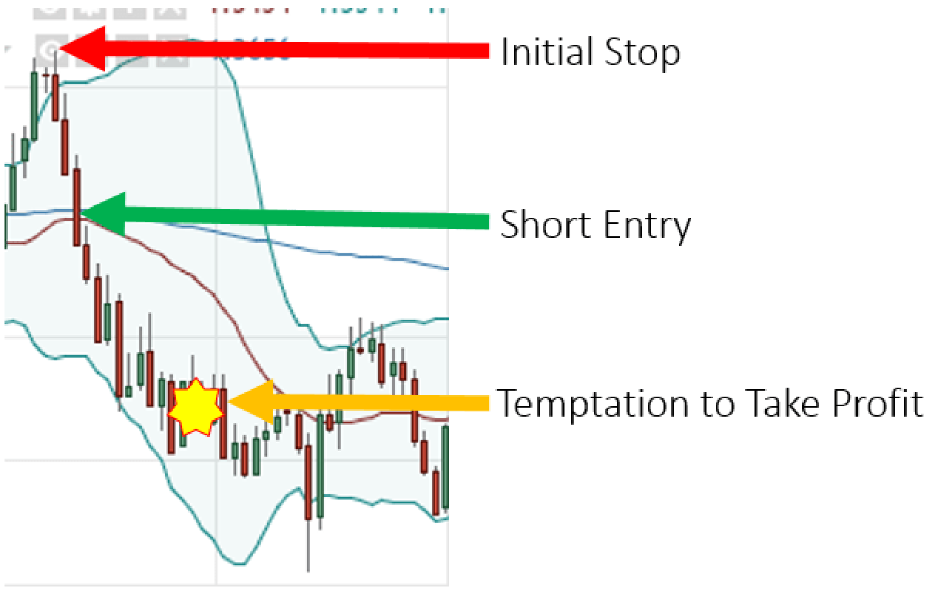
As can be seen above, though you still had 4 Profitable trades (i.e. the win rate still remains 40%) – by taking profits too early, you never allow yourself the opportunity to recover all the profit that was set to counter the impact of the expected losses on the other trades.

So if you continue to "take profit" like this, you will consistently be grinding your portfolio balance lower until you are out of the game… assuming of course you don't follow any of the other recommended risk mitigation techniques.

So how would Trend Traders use the RRR?

Seen below is an example of where one may enter a trade as a result of price action crossing downward through a major trend line.

At this point, you will have your stop loss levels set, and can manage the trade so that if the stop is triggered, you do not lose more than a certain % of Capital – so this rule remains firmly in tact…



However, as explained earlier, there really is no way, especially at the onset of the trade, to predetermine to what levels the price will move in line with the trend.

Secondly, as the trade unfolds, one can be very tempted to take profit at the first sign of resistance or consolidation levels, thinking that the deal has run in your favour for a while and with an itchy trigger finger rather want to take profit off the table.

This is the point where a RRR calculator comes in handy.

Knowing your historical win rate one can make a judgement call on whether or not to take profits early or not, or at minimum, adjusting the Take Profit level to one achieving the desired profit target required in line with your "RRR-Win Rate" calculations.

In this instance, and especially since no threat to the trade exists, the RRR can be used to determine the most ideal, and minimum level at which one should consider taking profit. Reminder – you always need to be aware of the fact that your wins need to compensate for your losses.

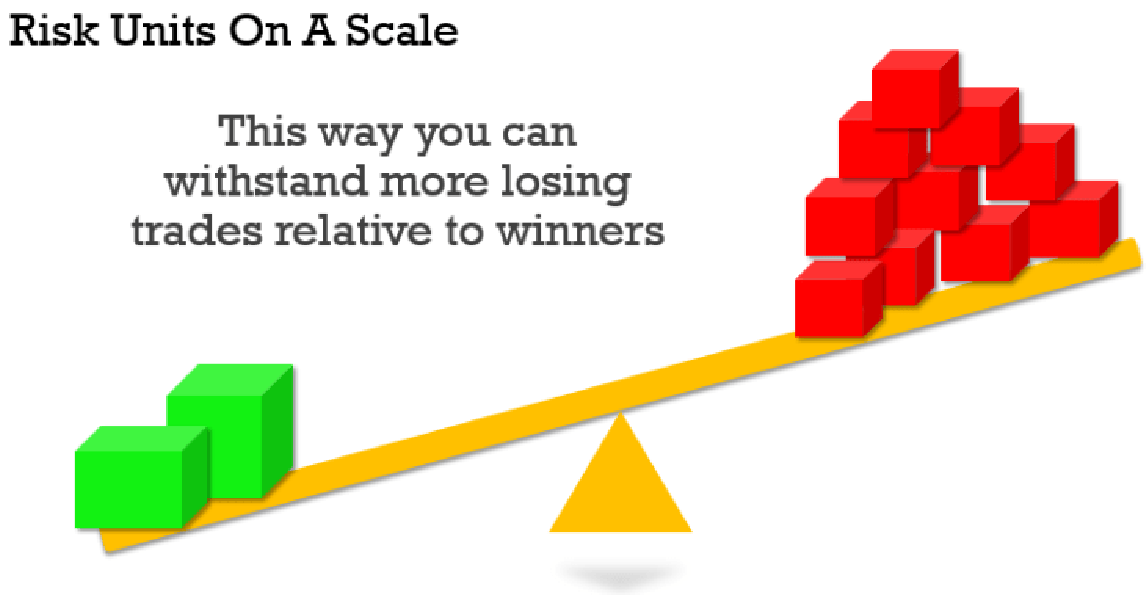
If you keep taking profit early, and never banking the true RRR of your trading strategy, your calculations are incorrect and you will find your portfolio still dwindling away even though you appear to hit your win/loss ratios.

Now, in reality, once the Minimum Required Return level is reached, one still would not automatically take profit. Instead we would want this trade to run as long as possible.

So unless the trade dynamics have changed, the more prudent thing to do is to continue to adjust your stop lower (on a trailing stop basis) and wait to see how much more of the trade can unfold until you have to exit, riding the trend for as long as possible and banking multiple Risk Units as profit.

Think in “units of Risk”

It is very helpful to evaluate your trading strategies, and the exit points, against units of risk.



You would still aim for the actual units of risk to be less than the actual units of profit you target, however by ensuring that the Risk Units are smaller than the Profit Units, your strategy stands a fighting chance!

This frame of mind will also assist in practice to help you refrain from taking profits until the “unit of profit” on that particular trade matches your criteria (obviously outlier cases exists, but you get the picture).

In the end, you are playing with a “big game” mentality where over the long run your strategy will tilt the scale so that your units risk is overpowered by the units of profit (regardless if they occur less in frequency than the risky ones!)

Chapter 9 – Which technical Indicators to use

In my opinion one of the biggest obstacles facing any new trader is the sheer number of different indicators and strategies out there that can be used to trade. So right out the gate I wish to give you this advice:

Start by using strategies and trading signals that requires minimal interpretation and/or user discretion.

Mainstream media and many financial educators will have you believe that you need to master numerous trading styles and techniques in order to be a successful trader. Their argument being that the markets can be all over the place, and they would want to prepare you to be able to apply all these various strategies to the various possible states the markets finds itself in at times.

This is a very intimidating thought to say the least!

No wonder many traders find themselves in a constant state of trading inertia, not knowing what to do next, or which technique to apply to any given market condition.

The good news however is this statement is not entirely correct nor even necessary. You see, the age old saying that "if all you have in your tool box is a hammer, then all your problems will look like nails" does not really apply to the market, it would,… if we only had one market to trade.

In our case the reality is that you can choose from a number of markets to trade, whether it is forex, stocks, bonds, commodities, or even an index such as the NASDAQ or CAC40. To go even further, each of these markets has an endless amount of individual securities to choose from.

A few examples are:

- Forex – EUR, CAD, GBP, CHF, AUD, JPY
- Commodities – Crude, Maize, Wheat
- Stocks – Microsoft, FaceBook, Volkswagen, Samsung
- Bonds – US Treasuries, Municipal Bonds

This list can go on and on and on….

Master A Few Techniques First

I personally prefer to introduce someone to trading by having them master a few techniques or indicators only, this implies a thorough understanding of "WHEN" to use these indicators, in other words, the most ideal market conditions required.

Then, with a watch list of only a relative few instruments or securities across various markets, the easiest thing on earth to do is to scan each item on the watch list regularly to see if they fit any of the trading conditions required by one of your techniques or indicators for a possible trade setup.

Once narrowed down and a possible trade exists, then perhaps only a few small final tweaks and checks and balances to complete and off you go,… ready to trade.

Why this technique is so successful amongst traders is that it assists you to cut through all the noise and intimidation. All of a sudden you are busy analysing only a hand full of possible trades and even better yet, you know exactly what to do and more importantly, how to enter and exit the trade if one exists.

The takeaway message here is that once you have a few strategies that you are comfortable in trading, you only need to trade when the market conditions exists, if not either look for another security (like moving from the EUR to CAD), or simply just wait …

Different Market Conditions

Broadly defined the market in general (and generally any security or instrument within a market) constantly moves between the following three states:

- Trending Up
- Neutral
- Trending Down

What confuses novice traders in particular, is that even within an overall upward trending market for example there could be periods of neutral (range bound) or even downward trending price action.

So trying to figure out every single market price action movement and trying to catch this "constantly falling piano" is at best left to those who prefer such complexity.

I will also be the first to admit that depending on the type of trader you are, your ability to move between indicators and markets become may be more prominent in some cases.

The good news however is, the fact that you are reading this will make life a bit easier for you. The trading strategies I will show you here will all predominantly be based on only a few key concepts, used on a balanced portfolio approach and summed up as follows:

OUR IDEAL TRADING STYLE = "LONG TERM POSITIONING"

+ "MEDIUM TERM OPPORTUNISTIC TRADES"

+ "BANKING REGULAR SHORT-TERM SETUPS"

+ "OVERLAYED WITH SOME YIELD ENHANCED STRUCTURING"

I know it sounds extremely complicated and just looking at that equation is intimidating enough, but trust me, .. you'll see that it really is not.

The reason being that once you have defined only a few signals within each one of these categories the entire process becomes somewhat automated. In fact, in less than 30 minutes a night you would be able to identify all the possible trade setups available. In the end, the result of all of the components of our Ideal Trading Style aims to positions you to:

Catch Major Trends

We will choose the type of trading we wish to do first and only then map this to the various indicators we need to master in order to trade.

- Monetise interim break-out movements within this Major Trend
- Trade very specific and narrowly defined trade set-ups (which is not dictated by the market's trend, even though you can skew your trade in that direction if it had a clear trend)
- Bank some yield-enhancement trades skewed in favour of the trend via the creation of very specific (and easily defined) option structures
- Start at your Desired Outcome and work your way back

Wouldn't you agree that this is by far the easiest way to go about it compared to learning hundreds of different strategies and trying to apply them at various times.

This will become clearer later as we go, so for now just understand that our method or trading strategy will not necessarily change depending on the market, but instead, we will only pick markets to trade once they fit into the conditions of our trading strategy.

What is the function of any strategy or trade signal anyway?

Realise that in the end, all strategies regardless of their technical complexity aims to do one of three things:

- To identify a trend, the relative strength of a trend or a possible change in a trend
- To identify when a market is considered range bound, and possible changes in this range
- To Identify positions to take when the market breaks out of an existing range or trend

By now you should agree with me when I say that, especially when just starting out, the best gift you can give yourself is to use trading signals or strategies that requires minimal interpretation. In other words, the easier you can make it on yourself to not have to interpret the indicator to better.

How to choose the indicators that suits you best

The choice of indicator is very dependent on your style, and for the most part your frequency of trading.

I highly recommend you read the chapter on How to choose the right indicators which will help you a lot in determining which type of indicator suits your personal style of trading best. In that chapter I also highlight the ones we will be focussing on most often, in short – a great place to start to assist you in your choice.

In the next chapter we will cover the following:

- For very active (high frequency) traders, price action viewed via chart formations are more important than signals
- Not all signals are created equal
- Stack your edges – trade only once you have 2 or 3 lined up
- Some instruments are inherently stats driven by the market – let others do the hard work for you
- Finally, once you have gained sufficient familiarity with traditional trading tools and signals, the next step would be to expand your "tool box" to include the ability to structure hedging solutions to reduce risk as well as adding some yield enhancement structures giving your overall portfolio a boost.

Chapter 10 – How to choose the right indicators

Many traders, especially when starting out find themselves in a constant state of trading inertia. This is predominantly due to not knowing what to do next, or more specifically which technique or technical indicator to choose from and to apply as their preferred style or method of trading.

The results of a quick Google search on the internet will literally scare the pants off anyone starting out, as the sheer number of different indicators and strategies to use under different market conditions are mind boggling.

In this chapter, I wish to get down to the nuts and bolts of how to make the choice, .. in other words, how to short list the right indicators that fits your unique style of trading.

Indicators vs Chart Patterns

There exists an age old debate as to whether using actual chart patterns are more beneficial to using indicators.

The debate tries to establish if observing a particular chart formation, established as a result of certain price movements, is a better tool to use than looking at other indicators in trying to identify a possible trade set up.

Indicators in this sense could be trying to determine the current market's conditions or state relative to that of a prior period, and from this trying to determine the possibility of a trade.

Let me clarify..

When prices are graphed day after day, traders tend to look at these charts trying to identify possible patterns or trading signals which they will use to somewhat and to a certain extent, try to pre-empt what they think will be the most likely next move the market will make.

For many traders, trying to get into a position before a big move is what they determine to be their "edge". For other traders though, the allure of being the first one to spot a new trend is far less attractive than just catching the ride overall, or to trade with a given comfort level that at least they are trading in the same direction as the overall trend.

Clearly, the above indicates that traders can look at the very same chart pattern yet react differently.

This in its most fundamental form explains why certain types of traders prefer certain types of patterns over indicators or vice versa.

Truth is that there really is no golden rule here,…. no magic ticket that shows you the clear winner.

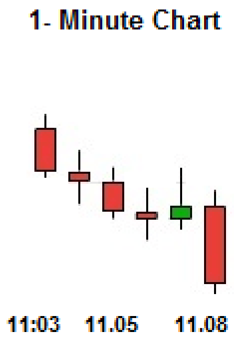
Your choice should match your trading style and personality

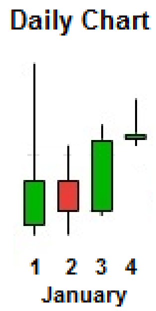
In real life you'll find that in the end, the bulk of trading styles uses the same generic principals, however the most likely change or tweak would be the time frame over which they measure these movements.

Scalpers for example will typically look for price action to reveal patterns or breakouts over a short time frame or period, by using "1-minute" charts, where swing traders will in all likelihood use "daily" charts.

What this simply means is a scalper needs to see every single minute's price action. Did this minute's price move up or down, relative to the minute before that or not?

The reality is that the charts does not necessarily look any different





The fact remains that your trading style ultimately dictates the time frame over which you will observe the market. Some strategies do not require you to be glued to the screens the entire day, so daily charts will do for those, and even more specifically, some may even require end-of-day charts only and don't even require you to be updated with live price movements as the market moves.

Anticipating the market or Following it?

The next step is to establish if your trading style requires you to pre-empt the market or not.

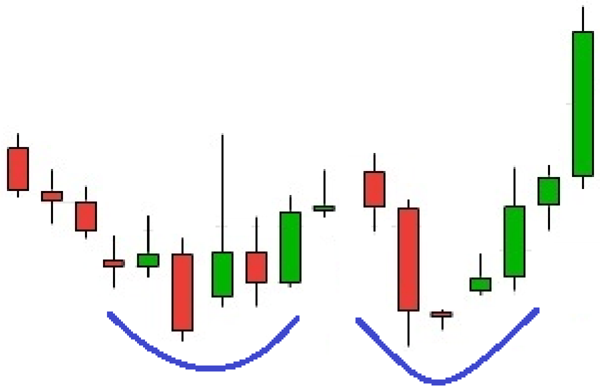
By pre-empting I mean that you are trying to be the first on to move, and then hopefully the market catches up.

An example of this would be via the use of Chart Patterns.

Chart patterns are interpreted from visual observations by the one analyzing the charts. The general idea being that if a ton of traders are observing the exact same action unfolding, one may be able to "predict" the upcoming trade direction to some extent.

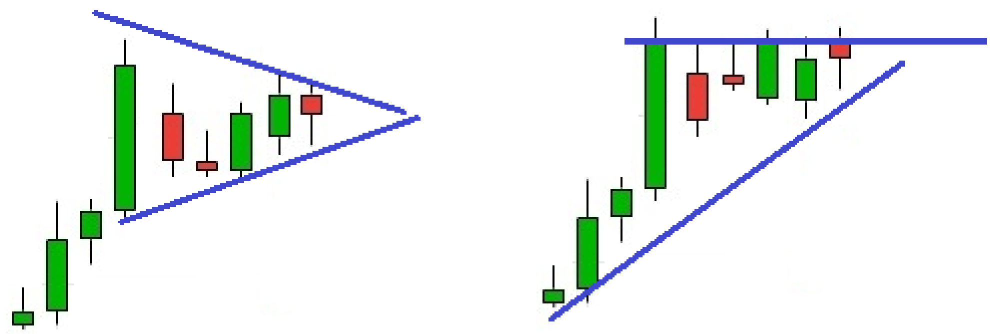
The problem with this statement relies on other observers to view and interpret the same exact same outcome. You will see later on that this perception can wreak havoc depending on the difference in observation points used.

Furthermore, and possibly more for a different chapter, but analyzing a security with little other followers (i.e. low liquidity) can also produce false or unreliable signals.



The aim of using chart patterns are that by observing the price action one aims to establish what the charts are telling you depending on the “picture” it is busy painting in the charts.

Using triangles or wedges as an example is an indication of prices being squeezed in one way or another and that a possible break-out is expected to occur. Such a break-out usually is expected to have some significant momentum behind it as the market gets rid of all that pressure of being squeezed into one place.



Reminder – don’t ever lose sight of the fact that market prices are ultimately just a reflection of whether there are more buyers than sellers at a particular time or vice versa. So in an upward shaping wedge for example, the sellers are trying their best to push the market lower, yet the bulls (buyers) are constantly there to stop the size of their downwards efforts. This tug-of-war continues to exist until the sellers finally give up and the price roars higher as the bulls celebrate their price victory.

Keeping this simple image in mind, it's easy to see why scalpers would keep a keen eye on these type of patterns, ever so ready to pull the trigger at the breakout of a wedge to catch the momentary spike as pressure is released.

But would a trend trader react in the same way?

Not necessarily……

A trader looking to catch a big overall momentum move and ride the wave, is far less likely to try and pin point the exact minute the market turned. In fact, most of the strategies used in these cases would rely on indicators rather than patterns.

A trend trader is far more interested in the strength of a trend than whether they caught the bottom or the top.

The graph below shows how "late" a trend trader can be to the party, not catching an exact bottom nor top.

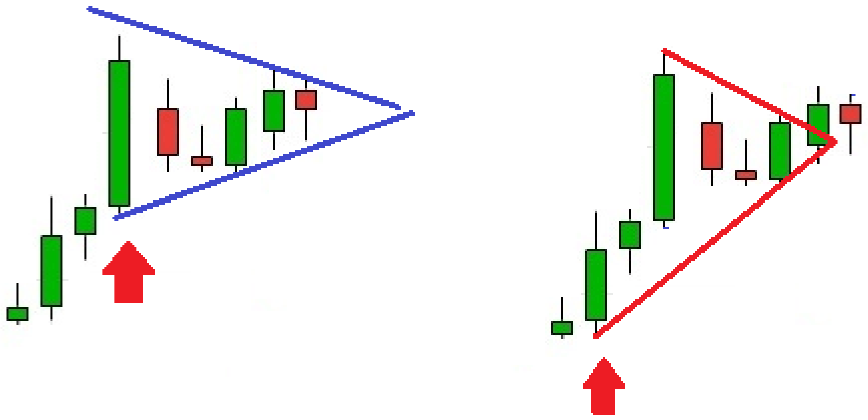
One can easily argue that there clearly would have been a better price to enter (and exit) had the trend trader been watching the market more closely. However, by giving the market time to unfold and for the trend to properly take shape though late to the party, the trend trader still stand to make a nice profit from following the change in the trend once identified and confirmed.

Avoid complex interpretation

Though the main aim of this chapter was to conclude the basic steps to follow in order to assist you in your decision-making process to determine which optimal patterns or indicators to use, I also wanted to include the ones I will be using most. It does not for one second imply these are the golden rules to follow, all I am to do is to remove some of the noise and point you to ones I have used a thousand times over, and the ones I know works perfectly well for what I intend to teach you here.

I am a firm believer in the fact that the most appropriate strategies to use (especially when starting out) are those where not a lot of individual interpretation is required.

Using chart patterns requires quite a bit of interpretation and drawing a support line at the wrong place, could imply completely different entry or exit prices than those of someone else observing the exact same price action unfolding.



Choosing the incorrect point to start from, or to connect to, can cause materially different observations and trade decisions.

Why risk it?

There are numerous indicators as an example which leaves far less room for interpretation. Yes, I know this is an understatement of the decision-making process but in general, and as an example, once a 50-day moving average crosses upwards over a downward sloping 200-day moving average, on the whole, chances are that a change in the trend is on the cards.

Similarly, a break of a 55-day high is a clear signal of a possible movement higher without having to interpret the exact point at which to enter, one can now rather spend time looking for a confirmation of this break.

You will no doubt agree that not a lot of interpretation is required to get us to this basic point of departure.

From here of course one can now compound other signals/indicators to measure the relative strength of the trend, the condition of the market (being over sold or over bought), all to support the confirmation of a possible trend change, or alternatively to identify if this is a possible fake-out that requires more time to observe.

What you'll see when we start talking about options is that certain strategies already have the statistics compounded in your favour. The very same fact that determines pricing of options requires the market makers to estimate that particular instrument's probability of exercise. So let them do the work and calculate all the variables and we just come in and use all that to our advantage, structuring suitable trades with the stats in our favor.

Which will we be looking at?

As highlighted on numerous occasions, depending on the type of trader you are, your ability to move between indicators, chart patterns and across various types of markets may be more prominent in some cases than others.

For what I am teaching you though, the truth is that you can afford to take a breather and relax.

A reminder that my ideal trading style covers the following broad areas:

OUR IDEAL TRADING STYLE	= LONG TERM POSITIONING
	+ MEDIUM TERM OPPORTUNISIC TRADES
	+ BANKING REGULAR "SHORT-TERM" SETUPS
	+ OVERLAYED WITH YIELD ENHANCED STRUCTURING

None of these require you to be at the tip of the knives' edge. You don't need to be there the minute the market makes a move to jump on it.

For the most part all the various possible trade setups we will engage in are enough to position you to:

Catch Major Trends

- Monetise interim break-out movements within this Major Trend
- Trade very specific and narrowly defined trade set-ups
- Bank some yield-enhancement trades skewed in favour of the trend
- Stacking your edges

The golden rule in trading is to protect your capital. It naturally follows then that the most conservative way in which to evaluate a signal to trade is to always maintain a position where that decision is only actioned (i.e. a trade is taken) if it can be confirmed or supported by two other indicators (at minimum one in certain circumstances).

Without the ability to “stack these edges” in our favour we would much rather pass on the opportunity or wait for all to be aligned before moving.

As an example, ideally, we would want:

- The market to be in an existing trend
- Our proposed trade to be skewed in the same direction of this trend (or opposite when it comes to selling options)
- That the strength of the trend is still strong
- That the markets momentum still anticipates movement in the same direction
- The price action supports the view based on where the market is trading at that point, relative to the immediate period preceding this possible entry point.

Our tools of choice

For each of the various components of our ideal trading strategy we shall be using different indicators. I am not going to go into detail of each here, but will do so once we physically get trading. For now, my aim is just for you to see the relative few indicators required to get going!

Just to clarify, the below list only summarises the indicators, and not the instruments we will use to trade once we have identified a possible trade.

As a quick example, for stock trades in particular, we may want to use a “stock replacement strategy” (structured via the use of option) instead of the actual outright purchasing of the stocks. In other words, we simulate the economics of the trade without actually physically having to enter the trade with the underlying physical stocks.

Our goal in this case may be improving (amplify) the return on the expected movement of the stock by committing less capital to the trade and in doing so greatly increasing the expected return on capital used to enter the trade.

Or for currencies, we may even decide to overlay a trade with a hedge structured via the use of zero premium option structures, in which we pre-determine the maximum best and worst case the trade can turn out, irrespective of where the actual underlying price movement goes.

Don’t worry if this does not make sense now, it all will – I promise.

The only reason I mentioned this point is for you as a reminder that trading is not a one-sided coin, in fact it probably closer resembles a coin with 10 sides (if that was even possible).

So here’s our “go-to” list of core indicators.

LONG TERM POSITIONING

Moving Average Cross Overs

Price Crossing Moving Averages

Seasonality indicators

MEDIUM TERM OPPORTUNISIC TRADES

Donchian Channels

Swing Days

Seasonality indicators

BANKING REGULAR “SHORT-TERM” SETUPS

Inside Days

OVERLAYED WITH SOME YIELD ENHANCED STRUCTURING

Deep ITM covered calls or puts

Getting “paid while you wait” entry and exit strategies

Selling low delta strangles

A surprisingly short list right?

A reminder that this list only covers the basics, but those basics are by far enough to get you started. The plus side of all this of course is that by only having to master a few indicators you can see how much easier the decision to trade can possible be.

Chapter 11 – Should I paper trade or not?

Ahhh, the golden question…..I was wondering when this one would pop up….

The debate around the benefits and drawbacks of Paper Trading probably extends as far back as the origins of the financial markets itself.

Back in the day, before computers and the internet made it possible for everyone to easily gain access to price information, paper trading used to be when you would jot down, and keep track of prices as though you would have taken a real trade in the markets. In essence as a form of practicing how to invest or trade, without using real money.

You literally would write down on a piece of paper your entry, exit, trade size, profit or loss on each "practice" trade in the particular market you were hoping to eventually trade or investing in.

The idea being that once you have practiced long enough, and started seeing some real results on paper, you would then be ready to migrate to the big leagues and start placing real trades, risking real money.

Nowadays this practice has taken on an electronic format where online brokers offers you the ability to simulate trading via virtual trading accounts (often called Demo Accounts). In essence, and online practice account set up with a broker, where everything resembles real life trading except for the fact that the account is funded with "play or pretend" money.

For many, this introduction to the financial markets is a crucial component to gaining confidence and comfort in their own abilities in a relative "safe space", before taking the big leap into real trading.

The Pro's of Paper Trading

Some key reasons why people paper trade include:

- Helps you choose and become familiar with the trading platform you use.
- Practice new trades, strategies, products, enter and exit order types, all with real-time market conditions (without the risk).
- For Algo Traders – it allows you to test your robot or algorithm for automated trading.
- It gives one the space to fine-tune and adjust trading strategies and methodologies.
- Help increase confidence that you can place trades and execute strategies.
- For many beginners it also allows them the ability to start learning while saving up to open a real trading account.

Most online brokerage platforms have a paper trading/demo trading account that you can use for free, even without having to deposit any money with the broker as yet. This is great because it allows you to see if that particular broker's platform fits your needs. If it doesn't then you just switch to another as there are plenty brokers out there.

In my experience the two main reasons for people to use demo accounts are either individuals who do not have enough money to open an account yet but wants to start to “test-drive” trading, or which is more often the case, to gain confidence before risking their own, hard earned money.

While these are all strong and solid reasons to consider paper trading, let’s move on to some of the drawbacks of paper trading.

The Con’s of Paper Trading

Some key reasons to skip paper trading:

- Paper trading artificially allows you to be emotionally detached from the outcome of a trade (instead of learning how to do so in real life – which is a COMPLETELY different feat altogether!).
- Since trading is a long-term endeavour, one can question the true effectiveness of paper trading given that by its very nature, it can only be done for a short period of time.
- You can afford to be sloppy and inconsistent with no real effects.
- Most trading platforms do not allow all available functions on a paper trading account so you don’t get exposure to the full suite tools available.
- Paper Trading can definitely give you a false sense of security.
- Mentally it is very different from trading real money and does not give you real world experience.

I guess my biggest issue with paper trading is that it really is not a true nor accurate resemblance of real life trading. Acting with the acute knowledge that nothing bad can happen has a definitive influence over on one’s behaviour (albeit subconsciously only).

Paper trading may give you a false sense of comfort that you are able to easily detach from your own emotions while trading. Also, without any real impact or consequence, if you make a mistake and do not analyze why you’ve made the mistake (or how you will ensure it does not happen again), you will most likely repeat the mistake when you start trading with real money in any event – this time perhaps with more disastrous consequences.

So should you paper trade or not?

I have a pretty straight forward opinion on this topic. I am not a big fan of paper trading. It is very very different from actual trading. I am a true believer in gaining actual experience in order to get better at anything. I don’t care how many “paper trades” you put on, none of that is a substitute for actual trading in the markets.

So instead of focusing on paper trading, I would instead promote that you rather spend the time to focus on controlling the things you can.

There are a ton you need to know BEFORE placing your first trade which can greatly assist you to mentally get over your trading inertia and fears.

In fact, understanding these basic principles is crucial preparation to ensure you enter the markets safely, irrespective of whether you have ever placed a real trade in your life or not!

These are:

- How to manage your emotions
- Understand how to limit your risk per trade
- Fierce protection of all your trading capital
- Start by only using indicators that require minimal interpretation
- Understand that you WILL lose – that is an unavoidable fact of trading.
- As such, gain familiarity with win-loss ratios
- Grab a Trading Journal and keep it updated

To be successful in the markets you have to be focused, take action, work smart and be dedicated. Paper trading doesn’t require any of that. Therefore in my opinion paper trading is pretty much useless as a tool to “learn” and “experience” what it is to trade.

As long as you stick to properly understand the basics I’ve highlighted above you’ll be fine. The learning curve may be a bit steeper but trust me that you will get trading far quicker this way.

Anyone who paper traded will end up surprised at how materially different paper trading is to real trading and will end up having to learn all these points above in any event… usually the key they all miss is the impact of your own emotions.

Believe me,.. when your own real hard earned cash is at stake you will want to watch those screens with a bit more intent than when you were just paper trading ☺

As highlighted earlier, one of the only reason I would use a paper trading account is to gain familiarity with the functionality of a specific platform, and at best this should only take you a few days at most to master, not weeks or months.

What?!.. you STILL want to paper trade!!

Ok, after having explored some pros and cons, and more particularly, where I stand on paper trading, I realize that some of you might still prefer to move forward in your trading journey by starting off with paper trading. That’s ok…

The one thing in trading is that you need to do what you feel comfortable with. Remember, this is a long term play and unless you do what comes naturally, chances are you probably won’t have any longevity.

So, with this in mind you can check out Globex360’s demo account… ultimately the decision is yours.

Chapter 12 – Final Thoughts

Trading should be fun, challenging, demanding… but fun

In this book I showed you exactly what you can do to give yourself the best chance of making it as a trader. You now have all the tools at hand to start on your journey. You now know what is expected of you and what you can expect from yourself.

Guarding against arrogance and ignorance is perhaps the most valuable lesson that can be taken from this book.

Guarding against arrogance:

Stay humble, only risk small amounts per trade, pick trading indicators that require little to no interpretation, pick a trading strategy and stick to it for a while before considering changing it, and if you have to pick one, why not use one that has been time tested by some of the greatest traders out there.

Guarding against ignorance:

Understand risk, understand your emotions, understand how to protect yourself from yourself. You WILL have losing trades, you WILL have losing streaks, but that's what the 1% rule, RRR and Max-draw-down is there to assist you with… use them.

Happy Trading!!