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Personally I'm always ready to learn, although I do not always like being taught.
Sir Winston Churchill (1874 - 1965)

In the beginning…..

I am going to start this book with a true story I sent subscribers of my newsletter. The reason I am going to start this with this story is that it illustrates many of the feelings you will experience as a trader.

It is also important that you read through the whole book and don't skip parts. I know how tempting it can be to scroll down and look for the juicy bits but this book isn't like that.

If you don't read from start to finish you will miss a whole lot and I mean a whole lot. The book is designed to educate you and hopefully make you a better trader.

The book is written under the assumption that you already know a little bit about trading. If you are a complete beginner then refer to your bonus ebook "Trading For Beginners". This will teach you the basics that you should know before you even try to start trading.

Here's what I want you to get from this book:
1. The knowledge of how to build your own trading plan
2. The most important parts of trading
3. Examples of successful trading plans

I can tell you that regardless of where you are in your trading, I have been there. I have been through the emotional roller coaster, the lost money and the doubt.

I can also tell you that when you get it right, it is like making a touch down or hitting the perfect golf swing.

Speaking of golf – I live on a golf course and often when I am trading, I can hear golfers teeing off. After a while, you can actually hear when a golfer has hit a good shot. It makes a different sound when they strike the ball.

Trading is like that in some ways. When you make a good trade it just feels right. You may not appreciate that if you are just starting out but trust me, you will intuitively know when you are trading in a zone.

My job is to help you get there.

So as I was saying, I am going to start off with a little story about a friend of mine…..

How to Make a Million In 40 Trades

This is a true story of how a friend of mine made a million dollars in 40 trades during a three-month period. I should mention first that he did start with $100,000.

I could have called this my Jerry Maguire moment. You know the movie with Tom Cruise where he decides to write a mission statement. The reason being is that the subject of this little piece (I will call him Fred to protect his identity as he is a real person) called me out of the blue last week and it brought back so many fond memories of my early days in trading.

Think of this - double a dollar 20 times and you have over one million dollars.

$ Dollars $	Doubled
$1.00	**$2.00**
$2.00	**$4.00**
$4.00	**$8.00**
$8.00	**$16.00**
$16.00	**$32.00**
$32.00	**$64.00**
$64.00	**$128.00**
$128.00	**$256.00**
$256.00	**$512.00**
$512.00	**$1,024.00**
$1,024.00	**$2,048.00**
$2,048.00	**$4,096.00**
$4,096.00	**$8,192.00**
$8,192.00	**$16,384.00**
$16,384.00	**$32,768.00**
$32,768.00	**$65,536.00**
$65,536.00	**$131,072.00**
$131,072.00	**$262,144.00**
$262,144.00	**$524,288.00**
$524,288.00	**$1,048,576.00**

Fig. 1

Before I start with this story I have to give you some background so that you can really appreciate the whole episode.

It all happened in the 90's. I don't even think the Euro Dollar had been introduced for trading at the time.

Anyway, it was fairly early in my trading career and a few years earlier I had taken a course on Forex trading in London. You know, one of those "I'm a guru and this is the Holy Grail courses".

I distinctly remember that the course cost me £8,500, which was a lot of money in those days, hell, it's still a lot of money for a course today.
At the time, I remember coming out from the course thinking that I had cracked it. I was already planning on the car I was going to buy and what sort of massive house I was going to live in.

The course finished on a Friday and by Tuesday I was set up with a broker and ready to make my fortune.

By the following Tuesday I had blown $10,000. I couldn't believe it. I had diligently applied everything I had learned and had still lost money. I was thoroughly depressed. At the time I knew very little about money management but I knew enough to know that I wasn't going to make any money trading the way I had been.

I spent the next six months reading everything I could about the Forex market. I became totally obsessed with the thing. I would sometimes work 18 hours straight, studying and testing different ideas.

During all of this, I kept in touch with the guy that originally taught me the course (let's call him Peter, as he is still in business as far as I know). I realized months later that the course was useless but by this time I had gotten to know Peter and he was a very likeable guy. It was hard not to like him even though I knew more than he did six months after I took the course.

At the time, I lived in a beautiful village in Scotland called Blairgowrie, in the heart of Perthshire. Just as a side note here. If you ever go to Scotland, make a point of heading up to Perthshire. Everyone goes to Edinburgh or Glasgow but trust me the farther North you go in Scotland, the more beautiful it gets and the people are much friendlier too.

So, picture the scene. I had eventually gotten my act together. I was making money trading but not a lot. It was enough to cover my living expenses and it was in the heady days before I had children, so there always seemed to be time for things. I would get up at around 5 am, make myself a big cup of black coffee, put on some Beethoven or Enya and settle in for the morning. My favorite technique was to try to catch a move during the London opening and be finished by midday.

It's funny, you know, but even I can see how the action in the market has changed over the years. The 5-minute charts just seemed easier to trade in those days.

Anyway, this left me time for my second passion of going to the movies. Both my wife and I used to be devoted moviegoers. I mean we would watch every single new release and even the arty foreign ones too. Nowadays, with kids, all I get to watch is Toy Story, The Lion King or Shrek over and over again.

Now back to the story. About a week before this story starts I was speaking with Peter and asked him if he knew where I could get a copy of a manuscript by WD Gann that I was after.

Anyway, about a week later Peter gives me a call and tells me that he has this guy called Fred who has just taken the course and is struggling a bit. He asks me if I would spend the day with him and just try to help him.

I knew, of course, that the reason he wanted me to help him was because he didn't want the guy to ask for a refund. Whatever the reason was, I wasn't interested. I was in my own little groove and life was good. I was doing OK in the markets, getting to see all the movies I could watch, in short I was happy.

This is where he tempted me with something he knew I would be interested in. Somehow he had managed to get his hands on the manuscript I was after. He wanted to make a deal. He would FedEx it up to me the same day if I would spend some time with Fred. He got me with the one thing he knew I would bite.

Arrangements were made that I would collect Fred from Edinburgh airport on Monday morning.

About two days before I was due to collect Fred, he called me. "Hi Mark this is Fred, Peter said that we are going to meet on Monday and I just wanted to touch base with you. So how much money are you making?"

Wow, this guy was to the point. I wondered if I had made a good decision by agreeing to spend the day with him.

Monday morning came and into the arrival lounge steps Fred. Big tall guy, over six feet tall. His hair was just starting to turn grey and he was dressed in baggy jeans and a T-shirt. I placed him about 36-40 years old.

"I thought I might see some sheep running around the airport. "What do you mean?” I said. "You know, highlands of Scotland, William Wallace and all that stuff." We both started laughing. I knew I was going to like this guy but he had a wicked sense of humor.

We made some general chit chat on the way back to Blairgowrie and eventually we got in front of the screen, where I started to explain how I trade.

Around this time I was really into Fibonacci and the approach I used at that time was the forerunner to www.surefire-forex-trading.com.

This is where the real story starts.

Fred just sat there looking at me. He had his face resting on his hand with his elbow on the table, which made his face all scrunched up like a cabbage patch doll. I went on for about half a hour. Then suddenly, Fred pretended to

let his elbow fall off the table. "Oh, sorry Mark, I was falling asleep. You could stun a pig with this stuff".

“What!” I said, but I knew exactly what he meant.

"Well, I'm not interested in all this crap. Just show me the good stuff, you know, the thing that makes the money."

“This is the thing that makes the money, Fred”.

"I'm not going to do all this mathematical stuff. There's got to be an easier way to make money than doing all this stuff. Plus, at the rate you make money, I might be 60 before I make any decent money."

I had to laugh. Fred was an entirely different animal from me. He wanted to trade and make it big but he wasn't prepared to do the work.

We spent the rest of the day talking about trading and life in general. I laughed the whole day. This guy only knew how to do things one way and that was with both barrels blazing.

Fred eventually went home and things returned to normal. A few days later I get one of many calls that were to come from Fred.

"Hi buddy, I set up my account last week and its live today."

“Great,” I said. “Remember to take it easy.”

"It’s a bit late for that me old matey, I'm short the Swiss for a million."

I just listened dumbstruck. You could and still do get incredible leverage with Forex. In those days there were no such things as mini contracts. I had just started trading with two contracts and here was Fred on his first trade, jumping right in there with ten contracts.

“How big is your stop?” I asked him?

"Stops are for wimps, buddy. When I make a couple of grand I'll close the position."

“Listen Fred, that's dangerous,” I said.

"Don't worry old matey. You can sit up there in the Highlands and watch the grass grow while I make the real money down here."

About three hours later he calls again. "Just made $5,000 buckos. Put that in your pipe and smoke it." I laughed but I was worried about him.

A few days later Fred calls again. "You won’t believe this. I was going to short the Pound so I went short 30 contracts and went out for a coffee. Anyway,

when I got back you will never guess what happened. I screwed up. I pressed the buy button instead of the sell button and now I'm up $15,000."

I had also been trading the Pound and there had just been a nice move but I had made about $1000.

“So what are you going to do now,” I said. “Are you going to close the position?”

"Hell no, Push it until it hurts me old matey."

He eventually closed the position later in the week and was up about $45,000. Over the course of the next few weeks Fred made about six trades and was increasing his leverage as he went. He was now regularly trading 30 contracts plus. After about a month and a half his account was standing at $500,000.

Quick Explanation
The pip value varies depending on which currency pair you trade but let’s say that a pip is worth $10 with one contract to make this easy. Fred was trading 30 contracts or about $300 a pip. If the pair moved 100 pips, that would be $30,000. Contracts in Forex are also commonly known as "lots".
****

Let’s get back to our story. It didn't matter how much he made, he wanted to use the maximum leverage he could and push his leverage to the limit. It was madness but no amount of reason was going to stop him.

He had also had a remarkable run. I don't remember the exact number but he had very few losing trades.

I was getting more worked up about his trading than he was. I eventually couldn't take it any more and told him I was flying down to see him. I was also curious to see how he was doing this. What mad method was he using?

As it turned out, his method was remarkably simple. Look at this chart

Fig. 1.2

Basically, at around midday GMT, he would just draw a straight line across the top and bottom of any consolidation he could see on a 5-minute chart. If he had a couple of closes above the consolidation, he went long. If he had a couple of closes below the consolidation he went short. There was either no stop or one so far away that it didn't matter much. He just closed the position when he felt he had made enough or judged the market to be turning on him. It was a sort of breakout technique.

Things came to a head when Fred went on holiday. He didn't particularly want to go on holiday but he had arranged this months before he started to trade.

He had arranged to take his family to Disney Land and off he went. Finally I thought, some peace and quite. But not quite!

He could only have been on the ground for a few hours when I got the call. "What's the Yen doing?" "Forget it," I said. "You need to take a break and spend some time with the family". Silence on the other end of the phone.

A few hours later he calls again. "Right, me old matey, I've just bought a fax machine. Fax me over a chart of the Yen." I couldn't believe what I was hearing. He wanted to trade without a dealing platform and no access to charts.

"No way Fred." I said.

"Listen up buddy, I am going to take it easy, I just want to be in the market. Send me a 5-minute of the Yen and I will keep it to 10-contracts." Reluctantly I agreed but made it clear I thought he was off his head. I knew that regardless of what I said he would find a way to trade.

As it turned out, even on his two week holiday he mad over $100,000. Obviously going over the 10 contract limit he promised me.

I could go on here about his trades but the incredible run finally ended one Sunday night after about three months and around 40 trades, Fred had managed to parlay his initial starting capital up to one million dollars.

Now, if you trade currencies, you know that nothing much happens on a Sunday night. Asia opens but generally there are no big moves.

The phone rang about 1 am and woke me from my sleep. "What the F%$* is happening to the Swiss?" He didn't even wait for an answer, he just hung up. I lay in bed for about ten minutes thinking about what Fred had said and then curiosity got the better of me! I had to go see for myself.

I knew as soon as I saw the chart what was worrying Fred. For some reason the Swiss had gone up over 100 pips on a Sunday night. I had never seen such a big move on a Sunday and I couldn't find any news as to why this might be happening. Fred must be short the Swiss I reasoned.

I decided to call him. “You’re short the Swiss - right?”

“Yes,” he replied. "I just don't understand it. I thought I would place my positions ahead of Monday’s opening and then this Sh*% happened. What do you think I should do?"

I didn't know. “Look, you really only have two options, close the position now or wait for the London open and see what happens. Whatever you decide put a stop in to be on the safe side.”

I remember watching that 5-minute chart of the Swiss all night long and about 8 am London time the Swiss began to rise again. It had moved another 80 odd pips up. I called Fred. “What did you do?” Silence. "Fred, what did you do?"

"I shorted it again. I thought that as it had already moved so much it must be ready for a pullback, so I shorted it again. There is something else Mark but I am too embarrassed to tell you."

“What is it Fred?”

"I've been adding contracts and now it’s looking real shaky."

I never did find out exactly how bad his situation was that day but I could guess. Not only had he shorted the pair again, he had added contracts.

After that trade, nothing seemed to go right for Fred. He had some wins but in a period of about a month, he lost everything, even his starting capital. He was the first trader I knew who actually had a margin call. That's when the

broker calls you to tell you that there is either not enough money in the account to cover the position or it is getting dangerously close to that level.

I still consider Fred a close personal friend and we have remained friends throughout all the years. It took some time for Fred to recover but he did eventual make quite a bit of money in the property game.

Here's the moral of the story. I have met some incredible traders over the years. I even know one trader who makes millions of dollars a year and before you ask, no, he doesn't share his method with me.

Of all the hundreds of traders I have met over the years, I only know a handful that still trade and make money year after year. All those traders without exception have strict money management principles and a simple method or system.

Don't be in a rush to make it in trading. You need to learn this profession. You need to have money management principles in place that allow you to stay in the game even when you go through a bad patch and trust me, they will come.

I asked Fred one day why he never stopped or drastically reduced the amount he was trading when he had a million dollars. This is what he said.

"I have a glandular problem. I have this huge greedy gland that just won't let me stop. When I got to a million, I immediately thought, why not ten million, me old matey."

Here's a scary thought. There was a time during all this when I would have believed that he could have done it.

Money Management and Real Traders

Money is better than poverty, if only for financial reasons.
Woody Allen (1935 -)

Now think of my friend Fred. How likely was it that he could have continued as he did?

That's the point of this chapter and it is also the most IMPORTANT chapter in the book and here's why.

Money management is more important than any system, method or anything else you will come up with. If you don't grasp the basics of money management then you will never make it as a trader. I would rather have an average system with great money management than a great system with bad money management.

Money management is the single most important factor that will determine whether you become a successful trader.

A bad trading method still might stand a chance if good money management principles are applied but even a great method will fail if bad or no money management is used.

Remember the first rule of fight club is - limit your loses. The amount you risk on any particular trade is one of the few things you can control.

Traders are not gamblers; they are statisticians. You have to look at the markets like a scientist would. If you do X, will you get Y? You should measure and record everything.

Before you trade, it is very important that you have some working knowledge of probability in order to maximize your trading technique. This might seem a bit dry but it is the building block of your trading plan. Nothing works without it.

Before I get started on exact money management principles, I want to introduce you to some basic probability.

Every time you place a trade you are calculating your probability of success or failure. You wouldn't enter a trade if you didn't think you would make money. You make a decision on the assumption that a particular trade (event) has a high probability of success.

The question is how much of an edge do you have on that event?

If you have an edge, then in theory, you will eventually make money. Or if you don't have an edge but the winning events far surpass the losing events, then you will make money.

Other factors have to be taken into consideration too, such as slippage and spread.

The first prize of course, is to have an edge and for your wins to greatly surpass your losses.

The first point I want to make about your trading is this. Even if you have an edge, you will at some time go through an aberrant run.

Let's say you have a method of trading with a 60% probability of success. Does this mean that for every 100 trades you will win 6 out of 10?

Not necessarily! You see, wins tend to be skewed. They are skewed in two ways. First, there will tend to be only a few really big winners. That is to say, if you made 500 points you might find that you made 100 points in one trade, 200 in another trade and the rest were all made up of 30 or 50 points.

The second way they are skewed is that you might find if you made a 100 trades and expected to win 60 of those trades - what 60 trades would you win?

The answer is that there is no way of knowing. How would you feel if the first 40 trades you made were all losses? Most traders would assume that the method or system didn't work and call it a day.

If you don't think that is possible, consider this. Imagine you have a coin and you wanted to try and predict how many times that coin would land on heads.

You decide to toss the coin in the air. It can only come down heads or tails. You know that these are the only two choices or probabilities.
If you toss the coin ten times, these are all the possible results:

10 heads and 0 tails
9 heads and 1 tail
8 heads and 2 tails
7 heads and 3 tails
6 heads and 4 tails
5 heads and 5 tails
4 heads and 6 tails
3 heads and 7 tails
2 heads and 8 tails
1 head and 9 tails
0 heads and 10 tails

Because the coin doesn't have a memory, it doesn't remember that it landed, e.g. 7 heads in a row or 7 tails in a row – so the chances are always 50/50. This is the law of independent trial.

The next time you have a beer with your buddy ask him what he thinks the odds are of tails coming up if you just tossed a coin in the air 10 times and every time it came down heads?

The point of this exercise is to make you think about probability. If you throw the coin in the air often enough it would eventually even out to 50/50. But if that were your trading account, would you still have enough money left in the account to see you through the bad runs?

Bad runs can and will happen to you at some stage and there is no way of knowing when.

***The easiest way for your children to learn about money is for you not to have any.
Katharine Whitehorn***

Dependent events

Trading is much more like Blackjack (casino card game). If you start with 52 cards. and the king of spades is dealt, what are the chances of that card coming out again on the same deck?

There is no chance. There are only 4 kings in each deck of cards. If you take out the king of spades, there is zero probability of the king of spades coming up again in the same deck of cards, as there is only one, and it has just been taken out.

This is actually the basis of card counting. Card counting is the process whereby each card in the deck is assigned a value and the card counter counts that assigned value as it is dealt. When the count is in the counter's favor he will bet more heavily.

Through the process of counting cards, a card counter can gain an advantage over the casino. This is why in certain countries a casino will ban a card counter once identified.

Blackjack obeys the laws of dependent events. If you have the mental capabilities, you can beat Blackjack. On the other hand, because roulette obeys the laws of independent events you will never beat it. It is a mathematical impossibility to beat any game that obeys the law of independent trial (events).

So what's all this got to do with trading? Well, everything, if you think about it. If you believe in the "random walk" theory, you are getting very close to an independent event and if you believed in the Dow Theory, then you would be close to dependent events.

Trading and Probability

As traders, we are attempting to make only high probability trades. In other words, we only want to trade when we believe the odds are in our favor. One way we attempt to find opportunities in our favor is through technical analysis.

Why You Should Never Double Up After Each Losing Trade

Doubling Up After Each Loss

First Trade	$100
Second Trade	$200
Third Trade	$400
Fourth Trade	$800
Fifth Trade	$1,600
Sixth Trade	$3,200
Seventh Trade	$6,400
Eighth Trade	$12,800
Ninth Trade	$25,600
Tenth Trade	$ 51,200
Total Lost	$102,300

Well, as you can see from the example above, if you doubled your position after each losing trade you would need a staggering $102,300 in your account just to cover your losses.

You might ask how likely is that to happen? And that, my friend, was the point of the previous few pages. Just think back to the example with the coins. An aberrant negative run can and **will happen**.

This is why I do not recommend doubling up after each loss. If you trade in a disciplined systematic manner, when your aberrant run does occur, you will still be in the game at the end of the run.

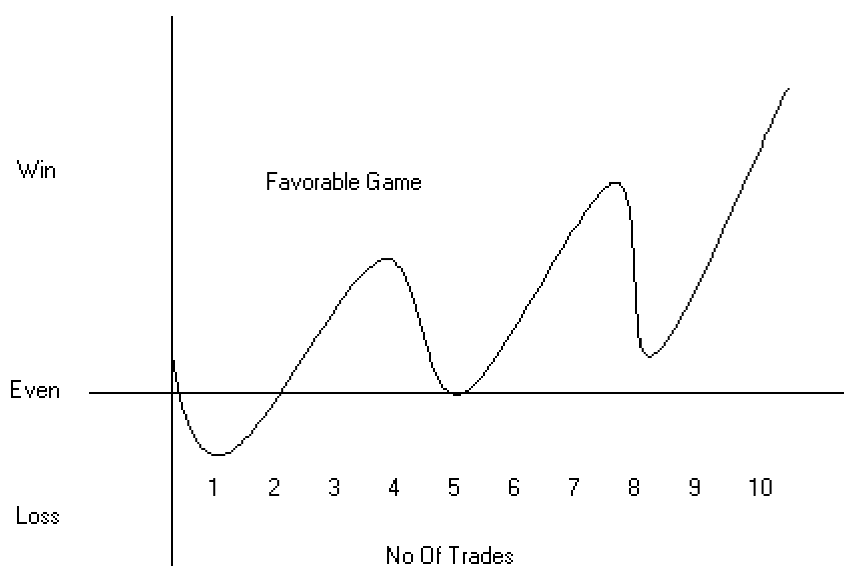

Fig. 2

Ideal situation

No Trades	# Wins	# Losses	Total Wins
2	1	1	1
4	3	1	3
6	4	2	4
8	6	2	6
Total			14

In the above example we made 14 out of 20 winning trades or 70%

Actual

No Trades	# Wins	# Losses	Total Wins
2	0	2	0
4	4	0	4
6	6	0	6
8	4	4	4
Total			14

The first example was a theoretical example and the second example is closer to what would happen when you are actually trading.

As you can see from the above, the actual may be different from the theoretical even though we land up at the same place.

Probability is a huge subject all on its own and we could go on forever explaining its ins and outs.

Here's a little interesting table for you:

Trades	% Win	# Of Losers To Expect
100	1.00	-
100	0.90	2
100	0.80	3
100	0.70	4
100	0.60	5
100	0.50	7
100	0.40	9
100	0.30	13
100	0.20	21
100	0.10	44

Fig.2.1

The Excel Formula Is =ROUND(LN(555)/-LN((1-0.50)),0)

Fig.2.1 is a table of the probability of how many losing trades could happen.

Trades = how many Trades
% Win = the win percentage of the method e.g. .50 equals 50%
 # Of Losers To Expect = the number of losses that could happen.

If you look half way down Fig. 2.1 you will see that somewhere during 100 trades with a method that has a 50% win rate, you can expect to have 7 consecutive losses in a row.

It is important to realize that regardless of the system or method of trading, there will be occasions when you have losses or even a string of losses.

When these occur, it is important to have faith in your trading plan and not to try and double up to catch up.

Finally, as you can see from the above examples, any trading system will go through times when it has more losses than wins.

This is where money management comes into play.

Drawdown

Drawdown is a dirty word in trading but every trader will experience some drawdown. It is simply unavoidable.

Imagine that you start your trading account with $10,000 and after a few trades you lose $2,000. Your drawdown would be 20%.

Now let's say you make more trades and gain $4,000 which brings you to $12,000 ($8,000 + $4,000 = $12,000). After this, on the next trade you lose $2000. You're draw down would be 16.7% ($2,000/$12,000). The $12,000 was your equity peak - as that was the highest point in the period we looked at.

Maximum Drawdown

Maximum drawdown is the lowest point your account reached between peaks.

If you started your account with $10,000 and the lowest amount you had in your account over a six-month period was $5000 then you had a 50% drawdown.

You would need to make $5,000 from the lowest point in order to get back to even. This is an important point because even though you lost 50% from your high of $10,000, you would need to make 100% on the $5,000 to get back to even.

Measuring Drawdown Recovery

Drawdown recovery can confuse many traders. If a trader loses 20% of his account, he thinks he needs to make 20% in order to get back to even.

This is, in fact, not true. If you started with $10,000 and lost $2,000 (20%) you would need to make 25% in order to get back to even. The difference between $8,000 and $10,000 is $2,000. If you calculate the $2,000 as a percentage of $8,000 (not the original $10,000) it works out to 25%.

Loss Of Capital As A %	% Required To get Back to Break Even
10%	11.11%
20%	25%
30%	42.86%
40%	66.67%
50%	100%
60%	150%
70%	233%
80%	400%
90%	900%
100%	Blow Out/Broke

Fig. 2.2

You can clearly see what's happening here. As your drawdown increases the amount you need to make it back increases faster.

I cannot emphasize this enough! You must be aware of risk. Understanding how basic probability and money management work is as important, if not more important, than any trading system.

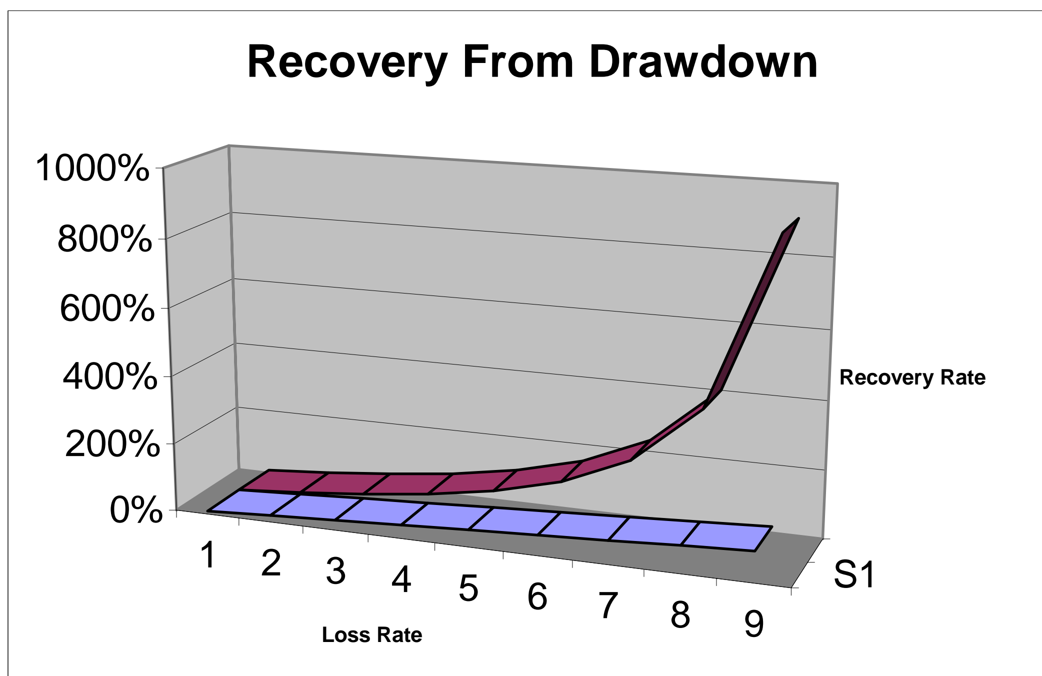

Fig. 2.3

This is the main reason I strongly advise new traders to use stop losses. If you use a stop then you will be able to define your risk.

If, for example, you decided to risk no more than 3% in any one trade, then the chances of going broke before you destroy your bankroll are minimal.

Trade No#	Equity	3% Of Equity	Equity	20% Of Equity
1	10,000	300	10,000	2,000
2	9,700	291	8,000	1,600
3	9,409	282	6,400	1,280
4	9,127	274	5,120	1,024
5	8,853	266		
6	8,587	258		
7	8,330	250		
8	8,080	242		
9	7,837	235		
10	7,602	228		
11	7,374	221		
12	7,153	215		
13	6,938	208		
14	6,730	202		
15	6,528	196		
16	6,333	190		
17	6,143	184		
18	5,958	179		
19	5,780	173		
20	5,606	168		
21	5,438	163		
22	5,275	158		
23	5,117	153		

Fig. 2.4

As you can see from the table above, if you risked 20% on each trade and had 4 consecutive losses in a row, your drawdown would be almost 50%. If, on the other hand, you only risked 3% on each trade you would need 23 consecutive losses to get to the same 50% drawdown.

If you think 3% is not enough to risk on one trade, consider this. I have never met a trader who has been in this game for any extended period of time that does not have some kind of stringent money management principles.

In fact, the majority of traders who have been trading for a prolonged period would argue that 3% is too much. They would feel much more comfortable only risking 1%.

I also want you to note that if you are trading more than one market or have more than one trade on at any given time, then the total amount you are at risk should be no more then 3%.

Let's say you are following three markets and have one trade on in each market. You should add up the total amount that you are at risk if all three trades lost.

For example, if you had a starting account of $10,000 and you had three trades on, each with a $300 stop loss, then your risk is actually 9%. Each of your trades has the potential to lose $300, so the total amount at risk is $900 which is 9%, not 3%.

Risk Reward Ratio & Risk Management

Take calculated risks. That is quite different from being rash.
George S. Patton (1885 - 1945)

Some traders think that working out the risk reward ratio on a trade is simply the amount you risk as compared to the amount you expect to make.

If you have a stop in place, which limits your risk to $1,000 but when your trade is successful you expect to make $3000, then your risk to reward ratio is 3:1

10 Trades	Loss	Win
1	$1,000.00	
2		$3,000.00
3	$1,000.00	
4		$3,000.00
5	$1,000.00	
6		$3,000.00
7	$1,000.00	
8		$3,000.00
9	$1,000.00	
10		$3,000.00
Sub Total	$5,000.00	$15,000.00

Fig. 3

From Fig. 3 above you can see that if you only selected trades where you thought you had a 3:1 risk reward ratio, then even if you were right only 50% of the time you would still make a profit.

Unfortunately life is not that simple. The problem is that you can predetermine your risk but you cannot predetermine your gain. You see, the market does not behave in a rational manner. Traders try and overcome this by varying their bet size (number of contracts they trade).

The size (number of contracts) you trade is inseparable from the equity you have in your account.

Stay with me here, my little Jedi Warrior. This next part is not as difficult as it seems.

Imagine we are in a beautiful Las Vegas Casino. The waitresses are scantily clad…. I'd better stop there. Anyway, you walk up to the roulette table and decide to place a bet. What is your risk?

Here is what is actually happening (American Roulette wheel with double zero – single number pays 35-1)

((1/38)*35)+((37/38)*(-1))
= (.02631578947*35)+(.9736842105*(-1))
= (9210526315)+(-.9736842105)
= -.05263157903.
Or a whopping -5.26% every time you bet.

Ok, if you're still awake, here's the point.

You bet $1 and lost 0.0526 (5.26 cents) or -5.26%
You bet $5 and lost 0.263 (26.3 cents) or -5.26%

You bet $1, then $10 then $5 and lose (84.16 cents)
(-.0526*1)+(-.0526*10)+(-.0526*5) = -.0526-.526 -.263 = -.8416 or -5.26%

The house edge of 5.26% always remains the same. Altering your bet size (contracts) makes no difference to the house edge. If the game has a negative expectancy then nothing you do will change that.

If you try and make money purely on varying the size of your bet (trade size) you are doomed to failure. If you don't have some kind of edge then no amount of manipulating, pyramiding or averaging will help. You have to have some kind of edge to make money.

The Kelly Criteria, Optimal f And Other Interesting Things

The edge

Over the years traders have tried just about everything imaginable to squeeze profits from the markets.

It has ranged from variation on the martingale system to sophisticated risk modeling. One of the most popular is the Kelly Criterion.

Some time in the 40's there were a group of Bell engineers who were trying to figure out the best way to optimize data transmission over long distance lines. The problem they had is that there was a lot of random noise over the lines.

As strange as it may seem there are a lot of similarities between data transmission problems and geometric growth as used to try and forecast the best way to get optimal results. They both deal with uncertainty. To cut a long story short, they came up with a solution, which is known as the Kelly formula. Traders and Gamblers used this formula to calculate what their optimum bet size should.

This is the Kelly Formula

Kelly % = W – [(1 – W) / R]

Let's put this magic formula to work. Take your last X trades e.g. your last 100 trades. The Kelly criterion assumes that you will have a constant win %, in other words, you will trade the same in the future as you did the past.

Next, work out your win %. If you have 60 wins and 40 losses then your win % would be 60% (.60).

The" R" part of the formula is calculated to get a ratio. If your average win is twice your loss then you would have a ratio of 2.

Here's an example:

You have made 300 trades: 200 wins and 100 losses. Your win loss ratio is 2. From the 300 trades you won 150 and lost 150. Your hit rate is then 50% (.50)

The Kelly Formula would look like this: Kelly =.50-(1-.50)/2

To Give YOU .25 or 25%

Some examples:

Win Prob	Win	Loss	Win/Loss Ratio	You Should Risk
1.00	200	100	2	100%
0.90	200	100	2	85%
0.80	200	100	2	70%
0.70	200	100	2	55%
0.60	200	100	2	40%
0.50	200	100	2	25%
0.40	200	100	2	10%
0.30	200	100	2	-5%
0.20	200	100	2	-20%
0.10	200	100	2	-35%

Fig. 4

See any problems with this yet? Let’s push on first.

To help illustrate this, imagine you are tossing a coin. Every time heads comes up, you win twice your original stake and every time tails comes up you lose your stake (2:1).

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In this example you have a hit rate of 50%. You win as many as you lose.

Fig. 4.1

Bet %	Start	Heads	Tails	Heads	Tails	Heads	Tails	Heads	Tails	Heads	Tails
0%	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
5%	1,000.00	1,100.00	1,045.00	1,149.50	1,092.03	1,201.23	1,141.17	1,255.28	1,192.52	1,311.77	1,246.18
10%	1,000.00	1,200.00	1,080.00	1,296.00	1,166.40	1,399.68	1,259.71	1,511.65	1,360.49	1,632.59	1,469.33
15%	1,000.00	1,300.00	1,105.00	1,436.50	1,221.03	1,587.33	1,349.23	1,754.00	1,490.90	1,938.17	1,647.45
20%	1,000.00	1,400.00	1,120.00	1,568.00	1,254.40	1,756.16	1,404.93	1,966.90	1,573.52	2,202.93	1,762.34
25%	1,000.00	1,500.00	1,125.00	1,687.50	1,265.63	1,898.44	1,423.83	2,135.74	1,601.81	2,402.71	1,802.03
30%	1,000.00	1,600.00	1,120.00	1,792.00	1,254.40	2,007.04	1,404.93	2,247.88	1,573.52	2,517.63	1,762.34
35%	1,000.00	1,700.00	1,105.00	1,878.50	1,221.03	2,075.74	1,349.23	2,293.70	1,490.90	2,534.53	1,647.45
40%	1,000.00	1,800.00	1,080.00	1,944.00	1,166.40	2,099.52	1,259.71	2,267.48	1,360.49	2,448.88	1,469.33
45%	1,000.00	1,900.00	1,045.00	1,985.50	1,092.03	2,074.85	1,141.17	2,168.22	1,192.52	2,265.79	1,246.18
50%	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00
55%	1,000.00	2,100.00	945.00	1,984.50	893.03	1,875.35	843.91	1,772.21	797.49	1,674.74	753.63
60%	1,000.00	2,200.00	880.00	1,936.00	774.40	1,703.68	681.47	1,499.24	599.70	1,319.33	527.73
65%	1,000.00	2,300.00	805.00	1,851.50	648.03	1,490.46	521.66	1,199.82	419.94	965.85	338.05
70%	1,000.00	2,400.00	720.00	1,728.00	518.40	1,244.16	373.25	895.80	268.74	644.97	193.49
75%	1,000.00	2,500.00	625.00	1,562.50	390.63	976.56	244.14	610.35	152.59	381.47	95.37
80%	1,000.00	2,600.00	520.00	1,352.00	270.40	703.04	140.61	365.58	73.12	190.10	38.02
85%	1,000.00	2,700.00	405.00	1,093.50	164.03	442.87	66.43	179.36	26.90	72.64	10.90
90%	1,000.00	2,800.00	280.00	784.00	78.40	219.52	21.95	61.47	6.15	17.21	1.72
95%	1,000.00	2,900.00	145.00	420.50	21.02	60.97	3.05	8.84	0.44	1.28	0.06
100%	1,000.00	3,000.00	-	-	-	-	-	-	-	-	-

Fig 4.1

In the table above (Fig. 4.1) you can see that at 25%, you wager 25% of your initial stake ($250) as your win ratio is twice your loss ratio. You make two times the $250 for $500 for a total of $1,500.

When tails comes up you lose one times your original stake (25% of $1,500 = $375) so your equity goes back to $1,125.

With a 2:1 win ratio and a 50% hit rate you can see that the optimal amount to bet with these parameters is 25% - Look at the chart below (4.2).

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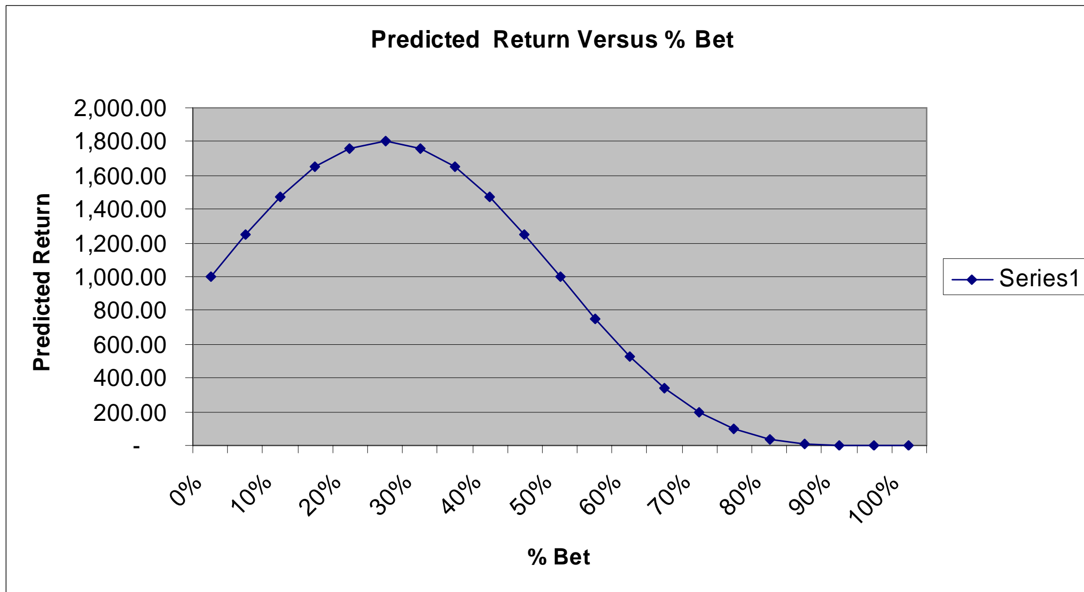

Fig. 4.2

Here's another example (Fig. 4.3) with a 60% hit rate. You win 60% of the time.

Bet %	Start	Heads	Tails	Heads	Tails	Heads	Tails	Heads	Tails	Heads	Heads
0%	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
5%	1,000.00	1,100.00	1,045.00	1,149.50	1,092.03	1,201.23	1,141.17	1,255.28	1,192.52	1,311.77	1,442.95
10%	1,000.00	1,200.00	1,080.00	1,296.00	1,166.40	1,399.68	1,259.71	1,511.65	1,360.49	1,632.59	1,959.10
15%	1,000.00	1,300.00	1,105.00	1,436.50	1,221.03	1,587.33	1,349.23	1,754.00	1,490.90	1,938.17	2,519.62
20%	1,000.00	1,400.00	1,120.00	1,568.00	1,254.40	1,756.16	1,404.93	1,966.90	1,573.52	2,202.93	3,084.10
25%	1,000.00	1,500.00	1,125.00	1,687.50	1,265.63	1,898.44	1,423.83	2,135.74	1,601.81	2,402.71	3,604.06
30%	1,000.00	1,600.00	1,120.00	1,792.00	1,254.40	2,007.04	1,404.93	2,247.88	1,573.52	2,517.63	4,028.21
35%	1,000.00	1,700.00	1,105.00	1,878.50	1,221.03	2,075.74	1,349.23	2,293.70	1,490.90	2,534.53	4,308.71
40%	1,000.00	1,800.00	1,080.00	1,944.00	1,166.40	2,099.52	1,259.71	2,267.48	1,360.49	2,448.88	4,407.98
45%	1,000.00	1,900.00	1,045.00	1,985.50	1,092.03	2,074.85	1,141.17	2,168.22	1,192.52	2,265.79	4,304.99
50%	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	1,000.00	2,000.00	4,000.00
55%	1,000.00	2,100.00	945.00	1,984.50	893.03	1,875.35	843.91	1,772.21	797.49	1,674.74	3,516.95
60%	1,000.00	2,200.00	880.00	1,936.00	774.40	1,703.68	681.47	1,499.24	599.70	1,319.33	2,902.53
65%	1,000.00	2,300.00	805.00	1,851.50	648.03	1,490.46	521.66	1,199.82	419.94	965.85	2,221.46
70%	1,000.00	2,400.00	720.00	1,728.00	518.40	1,244.16	373.25	895.80	268.74	644.97	1,547.93
75%	1,000.00	2,500.00	625.00	1,562.50	390.63	976.56	244.14	610.35	152.59	381.47	953.67
80%	1,000.00	2,600.00	520.00	1,352.00	270.40	703.04	140.61	365.58	73.12	190.10	494.27
85%	1,000.00	2,700.00	405.00	1,093.50	164.03	442.87	66.43	179.36	26.90	72.64	196.13
90%	1,000.00	2,800.00	280.00	784.00	78.40	219.52	21.95	61.47	6.15	17.21	48.19
95%	1,000.00	2,900.00	145.00	420.50	21.02	60.97	3.05	8.84	0.44	1.28	3.72
100%	1,000.00	3,000.00	-	-	-	-	-	-	-	-	-

In the above this example (Fig 4.3) you can see that your optimal bet is 40%

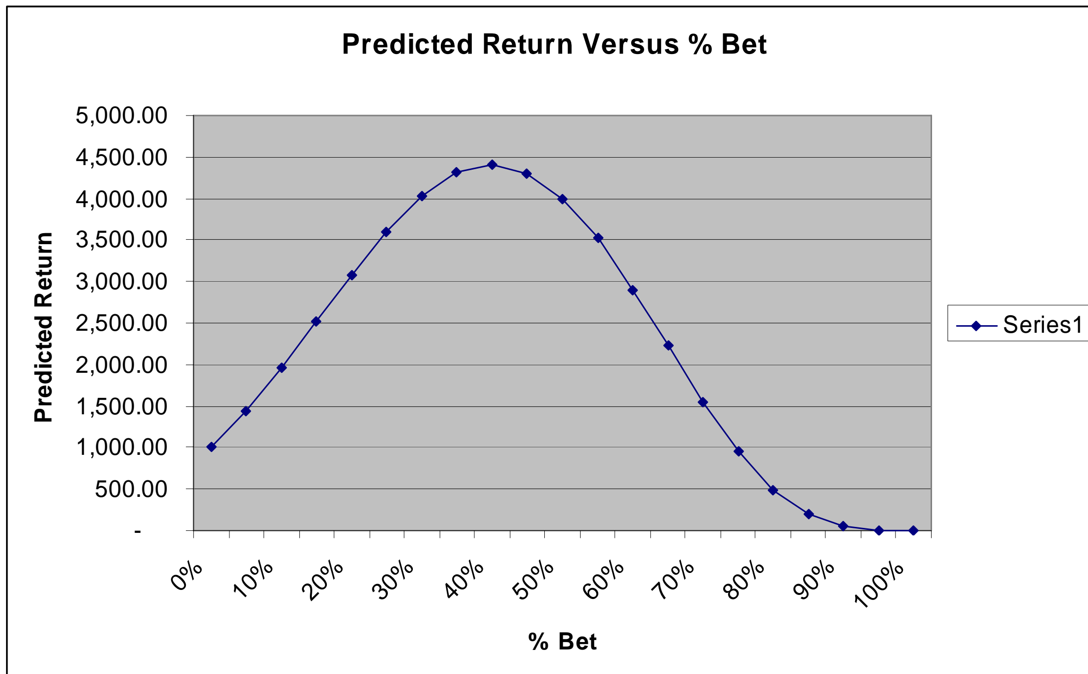

Fig. 4.4

There is one major problem with this and all similar theories. Remember our drawdown to recovery chart:

Loss Of Capital As A %	% Required To get Back to Break Even
10%	11.11%
20%	25%
30%	42.86%
40%	66.67%
50%	100%
60%	150%
70%	233%
80%	400%
90%	900%
100%	Blow Out/Broke

Fig. 4.5

If we bet 40% of our equity and lose we would need to make 66.67% on the next trade to get back to break even.

Therein lies the rub, my friend. Even with a purely mechanical trading system, with thousands of trades backtested, there is no way of knowing with certainty what the outcome of the next trade will be.

There is just no way I could bring myself to trade 40% of my equity on any one trade or even 40% split among a basket of markets.

Think about this. One of my best performing methods was www.traderssecretcode.com. In the last six month I have not had a losing trade. This would imply that I should bet 100% of my equity each time I trade. But as you and I both know, losers will come and Murphy 's Law dictates that the first time you do it, is the time you will get caught.

This is not to say that you shouldn't increase the amount you trade when you feel comfortable with your method or system and know through record keeping what your average win and hit rate is.

All I am saying is that majority of traders are discretionary. That is to say they decided when to enter and exit a trade, but because it involves human emotion there will be wide variation of win and loss rates over time.

I think a more conservative approach is always the wisest move. If you are determined to wager a % of your equity then I would suggest 10% of Kelly as a more practical approach:

Win Prob	Win	Loss	Win/Loss Ratio	You Should Risk	10% of Kelly
1.00	200	100	2	100%	10.0%
0.90	200	100	2	85%	8.5%
0.80	200	100	2	70%	7.0%
0.70	200	100	2	55%	5.5%
0.60	200	100	2	40%	4.0%
0.50	200	100	2	25%	2.5%
0.40	200	100	2	10%	1.0%
0.30	200	100	2	-5%	-0.5%
0.20	200	100	2	-20%	-2.0%
0.10	200	100	2	-35%	-3.5%

Fig. 4.6

Let me just add before I finish this little bit that I am not a mathematician or a trading GURU. There are those who would argue with this and present bookloads of statistics to show me how wrong I am. But few of them will show you their trading account!!!!

If all of this is too much for you, risk the smallest amount possible on each trade. If you have the funds, only have 2% at risk at anyone time. If you can afford it, only have1% risk at any one time.

So How Much Do You Want To Make

Fig. 5

	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
Start	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00	2,000.00
Month 1	2,020.00	2,040.00	2,060.00	2,080.00	2,100.00	2,120.00	2,140.00	2,160.00	2,180.00	2,200.00
Month 2	2,040.20	2,080.80	2,121.80	2,163.20	2,205.00	2,247.20	2,289.80	2,332.80	2,376.20	2,420.00
Month 3	2,060.60	2,122.42	2,185.45	2,249.73	2,315.25	2,382.03	2,450.09	2,519.42	2,590.06	2,662.00
Month 4	2,081.21	2,164.86	2,251.02	2,339.72	2,431.01	2,524.95	2,621.59	2,720.98	2,823.16	2,928.20
Month 5	2,102.02	2,208.16	2,318.55	2,433.31	2,552.56	2,676.45	2,805.10	2,938.66	3,077.25	3,221.02
Month 6	2,123.04	2,252.32	2,388.10	2,530.64	2,680.19	2,837.04	3,001.46	3,173.75	3,354.20	3,543.12
Month 7	2,144.27	2,297.37	2,459.75	2,631.86	2,814.20	3,007.26	3,211.56	3,427.65	3,656.08	3,897.43
Month 8	2,165.71	2,343.32	2,533.54	2,737.14	2,954.91	3,187.70	3,436.37	3,701.86	3,985.13	4,287.18
Month 9	2,187.37	2,390.19	2,609.55	2,846.62	3,102.66	3,378.96	3,676.92	3,998.01	4,343.79	4,715.90
Month 10	2,209.24	2,437.99	2,687.83	2,960.49	3,257.79	3,581.70	3,934.30	4,317.85	4,734.73	5,187.48
Month 11	2,231.34	2,486.75	2,768.47	3,078.91	3,420.68	3,796.60	4,209.70	4,663.28	5,160.85	5,706.23
Month 12	**2,253.65**	**2,536.48**	**2,851.52**	**3,202.06**	**3,591.71**	**4,024.39**	**4,504.38**	**5,036.34**	**5,625.33**	**6,276.86**
Compounded	**12.68%**	**26.82%**	**42.58%**	**60.10%**	**79.59%**	**101.22%**	**125.22%**	**151.82%**	**181.27%**	**213.84%**

Fig. 5.1

	50%	100%	200%
Start	2,000.00	2,000.00	2,000.00
Month 1	3,000.00	4,000.00	6,000.00
Month 2	4,500.00	8,000.00	18,000.00
Month 3	6,750.00	16,000.00	54,000.00
Month 4	10,125.00	32,000.00	162,000.00
Month 5	15,187.50	64,000.00	486,000.00
Month 6	22,781.25	128,000.00	1,458,000.00
Month 7	34,171.88	256,000.00	4,374,000.00
Month 8	51,257.81	512,000.00	13,122,000.00
Month 9	76,886.72	1,024,000.00	39,366,000.00
Month 10	115,330.08	2,048,000.00	118,098,000.00
Month 11	172,995.12	4,096,000.00	354,294,000.00
Month 12	**259,492.68**	**8,192,000.00**	**1,062,882,000.00**
Compounded	**12874.63%**	**409500.00%**	**53144000.00%**

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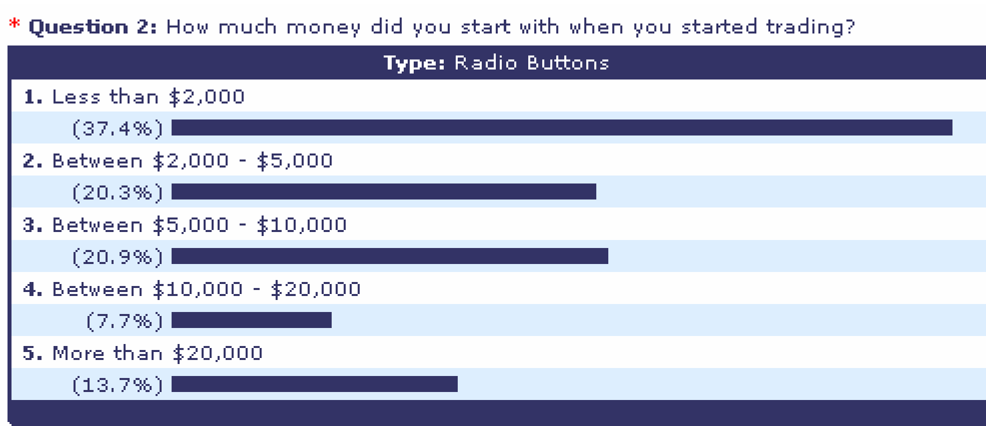
There are two tables above – Fig 5 & Fig 5.1. Both start with a starting equity of $2,000. Column 1 of the first table (Fig 5) shows what would happen if your account equity increased by 1% for 12 months. You can see that you would finish the 12 month period with a compound return of 12.68%

You can also see on the second table (Fig 5.1) that if your account increased by 200% per month, then you would be a Billionaire in 12 months – sounds easy doesn't it.

The scary thing is that if you did the math, it would be possible, as I am going to show you now. There is also a reason I chose $2,000. You see in a recent survey I did of my subscribers, I asked them "How much money did you start with when you started trading.

Fig 5.2



As you can see, 57.7% started with under $5,000 and the largest section started with under $2,000. Now here's the scary fact. In another survey I asked what sort of returns they expected to earn and the highest % all said over 100% per year.

Let's assume that an active trader trades once per day and that there are 5 trading days in the week or 20 days per month (I know there are more but let's keep this simple). If he has a 60% hit rate (wins 60% of the time) then he will win 12 and lose 8 trades.

Let's take this a little further. Let's assume he applies good money management and only risks 3% on his trades. If he started with $2,000 then he would only have $60 risk at any one time (assuming a flat rate of $2,000 each time he trades). Now let's also assume he wants to make 2 times his risk when he wins so that when he wins he makes $120

Let's do the math.

Wins12 trades @ $120 = $1,440
Looses 8 trades @ $60 = $480
Net = $960 or 48% gain on original equity in one month.

Not to shabby considering that the best minds in the financial world would be happy with 2-3% per month. There are also very few businesses that would return that regardless of their size.

If you go back to our table you can see that at a 50% increase on equity over 12 months you would have $259,492.68. Now that's impressive. After 54 month's you would be a Billionaire and after about 80 months you would have all the money there is on the planet. Not bad for a little guy that started with 2 grand.

So if it's so simple, why hasn't anyone ever done it? If it's that easy to make money trading just using good money management, why doesn't one guy have all the money?

That, my friend is the 64 million dollar question and one I hope to answer in the next section.

Before I move onto why it's almost impossible to grow like the chart suggests, I want to just summarize the first part of this whole section.

Summary

- The first objective in money management is to preserve your account (not to lose money). Risk as little as you can.
- Most traders with small accounts will want to risk a higher percentage of their capital than they should but try and keep your risk to between 1-3%. The greedy gland may get the better of you on occasion so just bear in mind that if you can't stick to 1-3%, risk as little as you can.
- Expect losses, they are part of trading.
- Try not to let your emotions get the better of you when you trade. A casino does not get upset when it loses a hand at Blackjack.
- No one knows the future and because of this you have no way of knowing whether the trade you are about to make will be a winner or loser. The only thing you can control is risk.
- If you lose more than 5% of your equity in any one month, stop trading for that month.
- The most important part of money management is knowing that the less you risk of your account the more trades you can make before running out of money. You will go through bad patches and you need the ability to sustain yourself during these patches by exercising good money management principles.
- The whole point of money management is that the better you use and look after the money you have, the more chance you have of making more money.
- Money is hard to make and easy to lose.
- Trading is not about fancy mathematics but real life results. If you can't come up with a method or system the gives you the edge – Don't Trade!

Let’s Get Mental

> ***Sometimes the mind, for reasons we don't necessarily understand, just decides to go to the store for a quart of milk.***
> ***Diane Frolov and Andrew Schneider, Three Doctors, 1993***

Why is it then, that if it is possible to make untold wealth that few traders have actually done it?

Well, there are a few reasons and I have my own theory on it too. Let’s look at a few of the reasons.

1. Very few traders will ever reinvest 100% of what they make. They need to live - right? That takes money, so they would need to take some if not all of the profit they make each month.
2. The psychological aspect. It’s all well and good looking at fancy charts and tables with nice rows of numbers but real trading isn’t like that. Real trading is a head game. At least 70% of trading is mental.

> ***All men are very much alike.***
> ***It is their habits which separate them***
> ***Gary Halbert***

Years ago I was going through a slump as a trader. I just couldn’t do anything right. For about three months I was breaking even. I was spending 12 hours a day staring at 5-minute charts and the end results was a big fat zero.

During this time I had become friendly with one of the brokers on a major London dealing desk. We often called each other and schemed how we would start our own brokerage one day. It never came to anything but I did ask him a very revealing question!

I explained to him that I was getting frustrated and just couldn’t get my act together. I asked him if he would do me a favor and go through his accounts and find a trader that was doing well and give me an introduction to him.

The plan was that if he would introduce me to a really good trader then I would call him up and ask if he would mentor me or even pay him for his time.

His reply shocked me. “Listen buddy” he said. “You are probably doing better that 99% of the traders on my books.” I couldn’t believe this. I said, “How can that be if I am breaking even?

His reply startled me even more. He told me that the average life expectancy of a retail trader (small guy) was three months before they blew their account.

That's why he wanted to start his own brokerage. The whole thing was like a casino. As long as a brokerage had enough money, the traders would all self-destruct given enough time. Sure there would be guys who hit it big now and then but none of them could do it consistently. All they had to do was offer good service, good rates and the numbers would take care of the rest. 90% of the traders would lose their initial starting equity in three months. How's that for scary!

One other interesting point came up from that discussion. Although he couldn't find anyone at that particular time to mentor me there was an analyst who they used to brief them that had a 20-year track record of more than 10% return per year- not leveraged.

He suggested I give him a call, so I did. Never having done anything like this before I was a bit nervous. Anyway I rang him up. The first thing that struck me was how loud this guy was on the phone. I began to wonder if I had done the right thing. I mean this guy sounded like he was one those top businessmen full of confidence. I pictured a Ken from Ken & Barbie look-a-like kind of guy. I could just picture the guy in my head, probably went to the gym every day and was immaculately groomed.

We arranged to meet at a hotel where he would collect me and then take me back to his place. We also came to an agreement on an hourly rate while he taught me.

As I was waiting in the lounge of the hotel this short little guy who looked like Homer Simpson walked up to me and asked me if I was Mark.

Well, he was nothing like I expected. He still had the big controlling voice but because he was so short he didn't seem so intimidating anymore.

His office was not unlike my own. A bit cluttered with two computer screens and piles of papers all over the place.

What was interesting was that he had these huge hand drawn charts in a pile. Each one was poster size but there were thousands of them. From the floor, it probably measured about three feet stacked high.

Anyway, to cut a long story short, he was a really nice guy. He was as smart as a whip and he really new his stuff.

He explained that because he had been at this since before there were computers on desktops he used to draw each chart by hand. He only used Point & Figure charts. He just never got out the habit of it. He also said he felt closer to the market when he drew the charts by hand.

Of course I asked him the obvious question. He had the longest track record of profitable years I had ever seen, I mean he had nearly 20 years without a loss. Why was he an analyst and not a trader?

He looked at me and laughed. “Do you think it is because I don’t want to be a trader? Of course I do. I just can’t trade.” I looked at him a bit puzzled.

He said that he had traded for many years but he just couldn’t stand the stress. He found that when he did analysis for banks and institutions he had no vested interest and could remain impartial. When it came down to using his own money, his impartiality just went out the window.

He recounted the story of one trade where he was so sure that the Pound was going short, that he went overboard on his risk parameters and lost a fortune. He told me that the mental stress and self-questioning after that one big trade finally put him over the edge. He decided not to trade again and stick to what he was did best.

His analogy was that in a racing team, there were drivers and mechanics. He saw himself as a mechanic. The mental pressure of trading was just too much for him even though he was one of the top analysts in the market.

Let me share a couple of personal stories. I remember one day I was trading the 1-minute charts on Forex with some fair size contracts. Because I was just looking to make 10 or 15 pips I was glued to the screen. I had to be there to make sure I got my exit just right to make a profit. A few minutes here or there made the difference between profit and loss.

Anyway, the doorbell rang and I tried to ignore it. It rang a few more time and I just ignored it. Then silence.

I thought that was the end of it, then a face appeared at the patio doors. Some guy in a suit was knocking on the window. I even tried to ignore him but he just stood there.

Finally I had to get up and open the door. It turned out it was some guy trying to sell me some kind of time-share. I can tell you he probably got the worst reception of his career.

By the time I had gotten back to my screen about 5-minutes had elapsed and I missed my exit. It probably cost me $1,500 on that trade.

I was hopping mad. I paced the floor wishing the salesman would come back so I could really tell him what I thought of him.

So much for impartial trading.

I also remember a student of mine who worked on the oil rigs who was on one month’s leave and wanted to know if we could get together. I always liked getting together with this particular guy because he was just so interesting.

We arranged that he would come through around 1 PM and go over his trades. I had a busy morning between trading and just sorting out the usual things you have to sort out in day-to-day life.

By this time my trading was coming together. With most retail traders you get a dealing platform and the thing just blinks the bid/offer price. You click buy or sell and there is no human interaction.

Larger institutions sometimes get what they call a commercial desk. Instead of just clicking the buy or sell button you are patched through to a live dealer who theoretically tries to get you a better rate. Because of my relationship with that broker, I was on the commercial desk. Half the time you end up talking crap over their help desk software.

On this particular day I had one of my biggest trades ever on. The phone started ringing, the doorbell went and my wife started calling me.

I did a quick check of the trade and decided that it wasn't going anywhere and closed the trade.

As it turned out, it was my student who had arrived. We spent the remainder of the day together and had a good laugh. Much later on in the evening, I went back to the charts to see what was what.

I looked at the screen blankly. According to my dealing platform I was down $27,000. I couldn't believe it. There must be a mistake. I quickly got on chat and asked the dealer why I was showing a position down $27,000. He said it was because I was in a trade.

"Impossible!" I told him. "I closed all my positions this morning."

It took almost 30 minutes for him to find my history of trades and there it was. Instead of closing the position I had actually added to it. I was short so instead of clicking the buy button I had clicked the sell button and added to my position.

I almost had a heart attack. I didn't know what to do. I watched the screen for hours. Now that it was definite that I had a position, I had to manage it. After about 4 hours I had had enough. I was down to about a $4,000 loss and I couldn't handle it anymore. I closed the position.

Here's the point. In each case, emotions play a huge role in your decision making process. It is slightly easier when you trade daily bars because you have a whole day to make a decision but intraday can really mess with your head.

After that episode I seriously thought about stopping trading. I just didn't like myself when things went wrong. I didn't like the idea of always worrying about my latest position. I also reasoned that if I had put the same amount of hours into a business I would probably have made more money.

This is one reason traders never reach their potential. It's very hard to be unemotional when it comes to your own money. Even guys who trade purely mechanical system screw up. They go through a losing run and pull the plug only to see the system kick back in and start to make money.

Get Real

Here's where I burst a few bubbles. Trading is not for everyone. Regardless of how you trade, trading will suit some and not others. Just as everyone was not designed or capable of being a professional musician, not everyone is design to be a trader.

It also takes time. I still consider myself a learner. I still read books, buy courses answer emails and test things out. I still feel my trading could improve a whole lot and I still get excited about it. The point is you have to evolve as a trader and often the mental stress will kill you before that happens.

Trading is probably the only business in the world where a guy from the street will start trading and EXPECT to make money. The average guy buys a course for a couple of hundred bucks, opens an account and thinks he has solved all his financial woes.

These are the guys who the other 10% make money from. They don't want to put in the hours or the testing or the research. They just want to have a go.

If you had a heart attack, would you want the doctor who does the operation to have 3 month experience? Of course not - you want an old guy with grey hair who has seen and done hundreds before.

The guy probably studied for 7 years and then studied some more under more experienced surgeons for years. By the time he got to touch a live patient he knew what he was doing.

Anything in life takes time to learn. It doesn't matter what it is, you need to do the groundwork first. You need to learn the trade. That's where discipline comes in.

I am often asked by my friends if I can teach them how to trade? My reply is always the same - sure, I can teach you how to trade but I can't guarantee you will make money.

It's likes this. If I were an artist, I could teach you how to paint but I couldn't teach you how to be a Rembrandt.

Here's what I want you to do. In the old days, I used to tell traders that once they thought they had a method or system that worked they should paper trade it for three months. That means just make imaginary trades and keep track on paper for that period of time. I only ever met one guy who could stick to this and he actually works with me now.

Anyway, with today's margins it is possible in some markets to start accounts for next to nothing and basically just mess around e.g. in Forex you can now open an account for $300 or less and practice.

It doesn't matter if you have $30 million, just open an account with the least amount you can. You have to adopt the attitude that you have written this money off in your mind. It must be money that you don't need for anything else. You are paying for the education of using real money.

Now even though it is a small account, I can tell you that human nature is going to make you try and increase it. It's just the way we are designed. Part of the psychology of trading is that it is not about the money. It is actually about winning and losing. Everyone wants to win.

Here's something else you will discover. Let's say you are in a trade and you are down a lot. You know you are in a losing position and you have the decision to either cut your losses or wait to see what happens. You know what, your instincts will tell you to wait, and see what happens because there is always the possibility that it will turn around and turn into a winner.

I have had situations in the past where I have had a losing position and it has come all the way back to a few dollars loss and I have waited to see the plus sign just so I wouldn't have a loser in my track record. This has cost me big time on more than one occasion.

I also had the situation where I had a 100% win rate for over 50 trades and I wouldn't close the position because I had some crazy idea that I could trade and never be wrong. I was determined to not have a loss. That cost me big time.

Trusting your instincts in trading will kill you. The reason a small account will help is because you get to experience the emotional side before risking meaningful money.

It will also allow you to step back after a few months and ask yourself if this is really for you. Like I said, it doesn't suit everyone. You might try it and decide, "Well, I gave it a go and it didn't work and it's not for me." If that's the case then you either never lost anything in your paper trading or you only lost a small amount if you opened your account with the bare minimum.

So how do you become a better trader if this psychological barrier is so tough to break? Well, there are a few things you can do.

The hardest is sheer discipline. You can have such strict rules for your trading method or system that regardless of the situation you stick to your rules.

I can tell you right now that if you can do that you are half way to making it as a trader.

To do this, it is best if you start thinking of trading as a business. Remember the phone bill still needs to be paid at the end of every month. The school fees still need to be paid and your wife's still going to nail your credit card.

If you can think of trading as business then you know that the first and major priority in any business is to make money. You can be philanthropic with your money once you make it but until then your first priority is to make money.

Anything that takes you closer to that goal helps you and anything that takes you farther away from that goal hurts you.

If you make bad decisions based on emotions then you have to look at it as a bad business decision. If a trade goes bad but you stuck to your rules then you made a good business decision and you can reexamine your model.

Now I don't want to get all touch feely with you on this subject but if you really can't control your emotions and you want to be a trader then you need to ask yourself some tough questions:

- What is preventing me from sticking to my trading plan?
- Why am I getting so emotional about my trading?
- Am I under too much financial pressure to actually trade?
- Am I trying to fix a financial problem by trading?
- What's the real reason I want to be a trader. Is it financial freedom, is it because if I have more money I think people will respect me more or is it that I think I would like the lifestyle.

That's just a few of the things you need to go through. Here's another very important point. Trading does not define you. If you were a grumpy old man when you started trading you will still be a grumpy old man when you are a trader. If you can't give $10 to your church at collection time then you won't give $10,000 when you make your first million.

Trading is a vehicle. It is a game that is played and like all great games it will find your strengths and weaknesses very quickly and exploit them.

One of things that helped my trading a great deal was the introduction of the mini account in Forex or the mini contracts in the other markets I traded. I used to be big on Indexes, FTSE, DAX, SIM & CAC. When they first introduced the CFD (contract for difference) I was delighted.

The reason it helped me was because I didn't care. Let me explain. How many times have you been on holiday and you bought something that you knew was just a waste of money but you bought whatever it was without really worrying about it. You just wrote it off in your head. Or you're in a toy store and your kid wants a wooden sword that cost $1. You don't even think. You just buy it.

That's what happened to me with the mini accounts. I was used to trading $10 a pip and when the $1 a pip came out I opened a couple of accounts just to mess around. All the ideas I had wanted to try but wasn't brave enough to try with my main account, I tried out in the small mini account.

Let me give you an example. Because I trade short timeframes I have to keep tight control of my stops. I might be long the Swiss Frank with a mini account and where I would normally bail out I just kept the position.

I thought, what the hell. What's the worst thing that could happen? It might go a few hundred points against me but it's still only a couple of hundred dollars. As long as I was convinced I was in the right direction I wasn't fussed. I wouldn't even check the account every day. I would just take a look at it now and then.

This is where it gets interesting. Because I wasn't emotionally involved with the position and in fact couldn't care less about the thing, I got some great results. I was very seldom wrong.

At the end of the day any market can only do one of three things – go up – go down or go sideways.

If the market was going up but I missed the best entry level, I just left it until the market caught up.

After a few months like this, I started to reexamine my whole trading strategy. If I was having such success with the little accounts then surely it was just a matter of money to apply this to my larger accounts.

It actually goes deeper than that. Where was my strength as a trader? Was I trying to pinpoint an entry on small time frames when I was actually better at guessing the general direction? If my strength was guessing the direction then maybe my approach should be more like a broadsword than a scalpel.

Every trader will be better at some parts of trading than others. You might find you have a knack for finding a great entry but you keep messing up your exit. You might find that you can judge exits great but can't get your risk right.

My weakness used to be the entry. I always had good money management skills, a good sense of direction and through analysis I was always able to get a great exit. But my entry was always a bit weak. So I applied my three strengths: money management and direction and exit strategy.

I was no longer that worried about the entry. With my style of trading as long as I got close to a good entry I was happy. If I missed the breakout, I just waited for a pullback. If I missed the breakout and the pullback but I thought there was still enough juice left in the trade I would jump in anyway.

This is a simplistic explanation I know but it is still fundamentally how I trade. You see it is all about getting to know yourself as a trader.

I know my trading method is sound so if I get a few trades wrong I don't beat myself up about it. The next trade is just around the corner.

The best advice I can give you is to make rules and stick to them. As part of the course there are a few mp3's that may help you get your mind in shape.

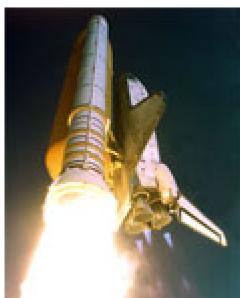
Don't overlook these. I know for some of you it might seem a bit strange listening to a recording telling you what you should be thinking but the right mindset will help your trading.

The other major advantage of sticking to your rules is that when you are wrong you will be able to look at those rules and see what rule failed and try to fix it. If you don't have some kind of rules you are trying to stick to, you won't know what to fix.

It's like the time you take your car to the mechanic and you try to explain to the guy what the problem is but for some reason the car doesn't have the problem any more. The mechanic can only fix the problem if he can find the problem.

Another point that may help is to stop blaming other people. If you think the system or method you bought doesn't work then stop using it. Don't use it as an excuse. At the end of the day it is your money. No one is going to give you back your losses. If you couldn't control yourself and you blow your account – that's your fault, no one else's. That's the whole point of starting small so that you don't get hurt. Nothing upsets me more when someone writes to me and tells me about how they were scammed out of **x** amount of dollars. My heart goes out to them but they were ultimately responsible.

Let's Build a Rocket



Before we start, let's have a look at two different approaches to the market:

Mechanical – when you are trying to trade in a mechanical way you are trying to take all the emotion out of your trading. If you succeed in building a mechanical trading system then you should be able to show that system to any amount of traders and they would all get the same results. There is no discretion in the system. If X happens then you do Y.

The great thing about this type of trading is that you don't have to make decisions. The system gives you a signal and you just trade it. No questioning if it is right or wrong you just do it.

Typically you would have researched an idea and then backtested (the process of testing a trading strategy on prior time periods) it on the time period you intend to trade. You could do this in two ways. If you are technically minded many charting services offer the facility to code and backtest your ideas. This can save you hours of time if you can get your head around the coding.

The other way of course is to just get a pen and paper and backtest by just doing a walk through each trade. You come up with an idea and just go back a few years on your charts and write down what the results of your concept would have been had you taken the trade according to your combination of indicators or entry and exit criteria.

You will find that in both cases the smaller the time frame the harder it is to get accurate results. If for example you had built a mechanical system that signals you to go in at X and out at Y using daily data, how do you know that you actually had a wining trade? If you look at the daily bar it might look like a good trade but the reality is that it might have taken you into the trade then hit your stop and then changed direction but when you just look at that one bar it looked good. The data used for back testing is very important and as far as I know, tick data is the best.

Because of the possibility for error, system traders try to use tick data or at the very least 1 minute data of the sale history. The problem with this is that there are many times when you get a bad tick.

Can you imagine building a system and the whole thing is built on flawed data?

I remember once when I was in the U.K many years ago. A fellow trader told me about this incredible system that he had bought and was having great results with it. I was immediately interested and called the system designer.

It turned out that this guy was some brilliant PhD in math and had built this mechanical system. It cost £1,500 per month but in order for it to work I had to be connected to the internet 24 hours a day, 7 days a week because it used 5-minute bars to determine the signals. The problem with that was that at that time in the U.K there were no monthly fees for the Internet. You had to pay by the minute and the cheapest rate I could find was AOL at 1p per minute. Connecting 24/7 would cost me another £400+ per month.

Anyway, I decided to take the leap of faith and take the whole package. It took me almost a week to set up with a DD feed.

After it was all set up I was looking forward to some money coming back my way. I woke up after the first morning and to my horror I had lost my internet connection half way through the night and the system had stopped. It took me another day to figure out how to put all the data I had lost into the system again so that I wasn't behind. The next day I was a bit nervous because I had lost the connection the night before but what happened this time was even worse. There had been a signal and I had been asleep. How could I solve that problem?

Well, after a lot of thought I went out and bought myself two of the biggest speakers I could find and a very long wire. I then connected the speakers up and ran the wire to my bedroom. I set up the system so that when there was a signal a really loud noise would go off. That was the plan.

Anyway the first time it went off at around 3am in the morning my wife almost hit the ceiling. I had the speakers turned up so loud it sounded like a World War II siren.

The next day at breakfast my wife told me in no uncertain terms that I was a nut case and she wasn't prepared to live like this for all the tea in China.

I resigned myself to just trading the day sessions and set up the speakers in my office. Remember we are going back 8 years and computers were not what they are now. This system was so resource intensive that I couldn't use the computer for anything else without the thing freezing.

I eventually bought another computer just so I could keep on working. To cut a long story short it took me about another month to iron out the kinks.

This is where the next problem came in. The system was what you would call a black box system. That means you buy the system but you never get to know how it works. All you see is the signals. The actual system converted the data into a bar chart and a little green for buy arrow or red for sell arrow popped up on the chart when you had a signal.

After about a month I had about 40 signals with 30 losing trades. I called the bright spark that designed the thing and asked him what was going on. He told me it was just going though a losing cycle and I should hang in there.

At the end of month two, the system had generated close to 100 signals with only 40% of them being right. I called wonder boy again. He said I might have a setting wrong and over the next week I spent countless hours on the phone with the guy.

By the end of month three the system had generated about 150 signals with only a 40% hit rate. I had wasted nearly four months of my life on this thing, lost money and given myself some serious headaches.

Would the system eventually get right? Maybe, maybe not. But it was beyond my tolerance level to find out. I just couldn't see myself wasting another 4 months to find out if the system worked or not.

Listen up friends. It doesn't matter what course, system or method you buy. You will never be truly confident in the idea unless you design it yourself.

Over the last few years trading bots have become popular. Bots enable you to build a system and have the bot automatically enter and exit a trade by communicating with your broker's dealing desk. It is a totally hands off approach.

I can't speak too much on this, as I haven't gone into the subject very much. I just don't know if I have the energy at this stage of the game but I can see that trading is heading in the direction of the technically savvy traders.

The Most Successful System I ever built.

Whenever I have tried to build a trading system I have always used good old Microsoft Excel sheets. This might seem a bit outdated for the new traders who have just entered the market but with each year that comes there is always a new technology and I just can't keep up with it all.

Normally I just import a whole lot of time and sale data and just mess around with it. A few years ago I came up with an idea, which used some variations on Fibonacci retracement and expansion levels. I designed it for the Forex market and the results on paper were impressive.

The only problem was that it traded every 8 hours. Originally that did not seem like a problem because I seldom sleep more that 6 hours and I reasoned I would always be around to take the trade.

After the first month I began to hate the system. I just hated the idea of always having to check something at the same time every day. It just became like a job. There were times when I was out for dinner when I needed to cut short my stay only to go back and put a trade on. It just took all the fun out of it.

My solution was to enlist one of my students. He would cover two shifts and I would cover one. There was very little work involved. It was just a quick check of the open, high and low of the previous 8 hour bar, input the numbers on the excel sheet and then place the trade according to what the readout was.

One of the problems we came across was that our broker did not always have the same reading as our chart service e.g. we might have a high of 1.2050, which would have meant a successful trade but the brokers high of the day was only 1.2044, which didn't trigger our entry order.

After trading the system for three months, we were up about 400 pips. This is good for a mechanical system but at the end of the day we both decided it was just not worth it. I still tinker with that system from time to time but now I concentrate on daily bars so that I only need to check it once a day.

Mechanical systems definitely have their place in trading but the same psychological stress you go through as a discretionary trader you will go through as a mechanical trader.

I will leave you with this thought. I knew this trader who had a signal service. Every day he would email his clients his recommendations for the day and the clients paid a monthly fee for this service.

I met him a few times and we swapped ideas on trading and it was a case of, you show me yours and I will show you mine. After I saw his method I understood what he was doing and it looked like a good solid method. He was sending good signals and trading the signals himself. Everyone was happy.

A few months passed and one of my subscribers asked me to recommend a signal service. I had no hesitation on recommending the trader I just mentioned. On his website he used to always display his track record. I used to check on it now and then and see if I beat him for the month. Over the months I sort of lost contact with him but an email someone sent me reminded me about him and I thought I would check out how he was doing.

I couldn't believe my eyes when I saw his track record. It had gone up 200% in three months. I got on the phone and told him what I had just seen on his website. My first question was, is that real? Did you really make that in the last three months?

He told me that it was and he had changed his whole approach to trading. You see he had come across the Holy Grail. Some math wiz had come up with a system that had been back tested to death and still held strong. Not only that but it had done extremely well in live trading.

I was jealous as hell and asked him to send me up a copy. He politely declined. This was just too valuable. I told him I understood but that he should just be careful as systems have a habit of blowing up.

Over the months to come I started hearing a lot about him from my subscribers and friends and how well he was doing. I was still worried about him pinning all his hopes on a mechanical system.

Then it happened. The website was taken down and I couldn't reach him. After another month or two by chance I did get in contact with him and asked him what had happened. He told me that his whole business was ruined. In one month, the system had managed to lose the previous 10 months profits. He eventually pulled the plug. He was getting so much grief from his clients that he just couldn't keep going. Not only that but he was finding it very difficult to get back into the groove of trading the way he used to before and was taking a break for a few months until he got his head right.
The moral of the story – Be careful of searching for the Holy Grail.

Method Trading – Let's Dance

So as we learned before, mechanical trading can be called system trading as it uses predefined rules to trade a system.

Method trading is a different animal. Methods come in all shapes and sizes and the vast majority of retail traders fall in the method group of traders.

A method can be anything from the seat of your pants to a set of rules you have researched and apply. The only difference is that with a method you have the ultimate decision of whether to take the trade or not.

Let's talk about a few method approaches. I once gave a lecture in London to a group of traders from financial institutions and some fund traders. Just before that start of the lecture I was so nervous that these guys would know so much more than I did that I was really stressing out.

For the first half of the lecture I drank so much water while giving the speech I had to stop and go to the bathroom.

I had a preconceived idea that because these guys controlled hundreds of millions of dollars that they would look at me and think what I was teaching was too simple.

As it tuned out I had nothing to worry about. At the first break a couple of guys came up to me and said that they thought what I was teaching was way above their heads and could I just simplify a few things.

I was very relieved but a bit confused because these were the guys that controlled huge amounts of money. The day was a great lesson for me. It taught me that just because someone trades a lot of money it doesn't mean he knows all the answers.

There were of course a few guys in the room who could have bought and sold me 10 times over with their knowledge but rather than display their knowledge they were genuinely interested in what I had to say and by the end of the lecture I was really enjoying myself. It had developed into a really good conversation and everyone just pulled their chairs closer as we swapped ideas and the more experienced helped the less experienced in the group.

That's one reason why I love being a trader. There is so much diversity in this profession and by and large most traders are very down to earth. They can't afford to be otherwise.

One very interesting guy I met ran a small (as he called it) fund for a group of Swiss businessmen. "I don't do any of that stuff Mark" he said on one of the tea breaks. "What do you mean," I asked? "Well, I have been trading for the last fifteen years and I don't think I have every drawn a line on a chart." I couldn't believe it.

"So how do you trade?" I asked. "Well," he said, "I do look at charts but only to see if the daily chart is going up or down. I ease into a position over a period of a month and I am really just looking for direction. I read a lot of research on the fundamentals and also the economic environment then I form an opinion and start easing into the position. I might be in that position anything from a month to 5 years."

This blew me away a little, as I had never met anyone with this approach before. He also used only percentages for stops and exits. He only risked a certain percentage of the equity in the fund and was looking to gain a certain percentage as a return.

He had no defined system but rather a holistic approach to the market. He took all the information he could find to make a decision and then made one.

Bombs Away

I also have a friend who is a true seat of your pants trader. I remember clearly trading the Dow Jones Index with CFDs (contract for difference). CFDs were the forerunners to spread betting and it was a way to trade indexes with very small contracts. For a long time I only traded the Dow Jones, CAC, SIM, DAX, S&P and NASDAQ this way.

The frustrating thing was that with a CFD the price is made up differently from the main market so there were often marked differences between the price of the main market and the price of a CFD. I will never forget being on the phone with a broker one day and as usual I could hear the faint sound of the trading floor in the background. That noise developed into a roar and the dealer I was talking to said, "Greenspan has just made a surprise interest rate hike. I have to go. Tell me now, do you want me to close the position or leave it open?". I thought for a second and said, "Close it."

My decision to close the position cost me around £10,000. I don't remember the exact number but the market went up around 300 points in a few minutes. I called my friend in London who I knew was also trading the Dow.

"Can you believe what just happened Mark? I just made £20k. The Dow just exploded for no reason." I told him what had just happened and that the reason was because Greenspan had just raised the interest rates. He started to laugh. Well, how cool is that.

You see my friend never really got into any kind of analysis. He never checked fundamentals or worked out Fibonacci ratios or used MACD, Stochastic or any thing most traders used.

I have actually watched him as he traded and all he did each day was sit down in front of a 1 minute or tick chart and just trade his gut feeling. He would watch the open of the market and watch to see if there was a surge in price and jump in or buy a pullback when he thought the market was going up or sell a rally if he thought the market was going down. All gut feel, nothing else. But, you know what, for the few years I was in touch with him he made his living trading this way. He did exercise good money management though.

He was a totally discretionary trader. Even though he didn't know it, he had a method. His method was gut feel. I haven't spoken to him for over 5 years but I would like to think he is still trading as he is one of the most down to earth and likable traders I ever knew.

Markets do change. One of my early mentors in trading made so much money that he bought some huge piece of land in California and went off to study Buddhism or something like that.

Anyway, before he went off to find himself he told me how he did it. He used to trade the Euro Dollar shortly after it was introduced. He traded spot Forex, which is traded 24 hours a day, in three sessions - the Asian, European and U.S. sessions. Each session corresponds roughly to the open of that countries stock market. As each session started, he reckoned he could see something as one session finished and another began. His favorite session to trade was the start of the U.S. session.

By watching the charts very closely on a 5-minute chart he could see when the U.S. session began to kick in and it often changed the direction of the market from the European session. This normally happened in a 1-hour window and that was when he jumped in.

I immediately went back through my charts and I could see surges and direction changes but I couldn’t predict it with any certainty. He agreed to call me each day for a week and walk me though his thought process.

The conversation normally went like this. “Can you see that pullback Mark?”, “Yes,” I would reply. “Well if the next 5-minute bar is an up bar then it will form a little V shape and I will jump in.”

We talked and talked and talked and each time he explained it to me I could see it but I couldn’t see it on my own. I just wasn’t seeing what he was seeing. Therein lies the rub, my friend with being a discretionary trader. Ask just about any two Elliott Wave traders which wave we are in and you will most likely get a different answer. Ask a pattern trader where the neckline is on a head and shoulders and you will get different levels or that there isn’t actually a head and shoulders at all. Even the most basic of technical analysis tools, such as a trendline is open to interpretation.

The point I am trying to demonstrate is that often a method is in the eye of the beholder. What makes sense to you may not make sense to someone else, so it is therefore hard to teach.

Does that mean you can’t make money by buying someone’s method? Well, that depends. Just as each of us is a collection of the opinions of everyone whom we have ever met, so my trading is a collection of all the courses and books I have read. Sometimes I will not take a trade in a method just because it doesn’t look right. I have been looking at some markets for so long that I have a feel for what a good trade looks like.

Sometimes all your indicators are telling you to buy but that buy signal has been generated in a sideways market or because of a news announcement and I just know that it doesn’t look right. Unless everything gels and all the indicators are telling me to buy I just don’t trade.

This feeling that it doesn’t look right is almost impossible to convey in the written word. It is just experience. That is why I emphasize that you must give yourself time to get experience and also use good money management to keep you in the game.

In my last course www.traderssecretcode.com I recorded myself taking live trades and the thought process that went along with each trade. Although the vast majority of clients had no problem viewing the videos I spent so much time trying to help people with their computer problems that I decided that this time it would not be a good medium to convey the message.

So where does that leave a new trader who wants to learn the ropes and wants to get into trading.

Well, of all the traders I have met over the years that are still in the game they all have the same things in common.

1. They have reduced their trading method to a set of rules that they follow to the letter. They only vary from those rules when experience tells them that the rules are wrong.
2. They all have extremely good money management rules in place. This never varies.
3. Their method is always simple.
4. They are independent of outside influences. They don't listen to anyone else's opinions.
5. They are passionate about trading.

The five rules above are the reason I am still in the game. I don't consider myself a Guru, expert or mathematical wizard. I just keep it simple.

I trade according to a set of rules and keep learning and studying and when I find something that improves my method, I add it to my trading like Lego. Over the years I have had methods that worked well for me and still do. But just like any good athlete you should always be trying to improve.

I have also had many subscribers who have taken ideas from my methods and gone on to become far better traders than I will ever be. Last year I had a subscriber who used the basics of one of my methods, molded it to suit himself and has gone on to great things. The last email I got from him was when he had just arrived in Singapore, traveling the world with his laptop. I don't want to mislead you here and make you think that everyone will do this because most traders won't. But I am proud of the fact that I had a small part to play in his education. The fact that even one idea I gave him helped him achieve his dreams makes me feel good.

Anyway, back to reality. The reason you absolutely must reduce your method to a set of rules is that it will help you with your discipline. It will help you with your money management. It will help you identify when you are wrong and it will give you a starting point.

Although method traders come in all shapes and sizes most of us mere mortals need a game plan to follow. That's the purpose of this whole book: To teach you how to build your own game plan. Later, I will give you some examples of trading methods that can get you started but nothing would make me happier than if you used these ideas to build your own trading plan. We all tend to believe we are smarter than the next guy so the only way you will really be confident in your system or method is to design it yourself.

Fundamentals

> ***Learn the fundamentals of the game and stick to them. Band-Aid remedies never last.***
> ***Jack Nicklaus (1940-)***

When I first started trading, I didn't know anything about fundamentals. I just assumed that if something happened or if some news story broke, it would reflect on the charts.

That was the extent of my fundamental analysis and it cost me big time. Here's why. The smaller the time frame you trade the more important fundamentals are.

How fundamentals affect a market is actually a big topic but for the purpose of this book I am actually referring to how news and political events can affect the market you are trading.

If you are trading weekly or monthly charts, a move of 100 points or pips may not affect you. If you are trading 1 minute and 5-minute charts, 10 points or pips can destroy you.

In the early days, I couldn't figure out why, for no reason the chart would suddenly spring to life. I had never heard of non-farm payroll. I thought CPI was some distance relative of the CIA.

The reality is that fundamentals and economic announcements do move markets. They can change the direction of a long-term trend and I have seen markets completely reverse direction after a major news release.

Fundamental analysis is a big topic and I don't claim to know all there is to know but I can give you the broad strokes.

Stocks

Broadly speaking, which fundamentals move a market depends a lot on which markets you follow. For stocks, the most looked at analysis is in the form of the company's financial statements. Traders and investors will spend hours sifting through a company's expenses, liabilities and assets, seeking any information they can find that may help them to make a decision to buy or sell.

The price is still important but many fundamentalists care more about the past performance of the company and how solid it looks than the price. The management of the company is also very important. This type of analysis is called quantitative analysis. The more numbers you look at the more quantitative it becomes.

By far the most looked at data are the quarterly and annual reports that are required by law in most countries. These reports cover such things as:

- A background of the company and what it does
- A summary of the previous year's financials
- Auditors report detailing how accurate the results are
- An in-depth look at the financial results and the main factors of the business
- The complete set of financial statements including balance sheet, income statement, statement of retained earnings, and cash flow statement
- General information on the company management and officers
- Letter to shareholders from the CEO or the top corporate representative

Investors are often looking for clues as to the company's future. For example, has the management mentioned any potential threats to the company in the future? How realistic are the results that have been presented. What is the companies' vision going forward?

It's like a giant report card for a company with the teacher's comments. For stocks these reports can affect not only the investor but also the day trading speculator as traders who are not paying attention may get caught by unexpected results.

Food & Agricultural Commodities

Food & Agricultural Commodities can be divided into three main categories:
Grains / Cotton
Livestock / Lumber
Soft Commodities (e.g. cocoa, coffee, sugar & orange juice.)

The U.S. Department of Agriculture releases several monthly and quarterly reports that supply statistics. The fundamental trader studies these statistics in order make an informed decision.

Financial & Currency trading

Financials can be driven by an entirely different set of fundamentals. The overall health of the economy can be very important to traders trading financial instruments. Most of them will watch the economic indicators such as Consumer Price Index, Gross National Product, Interest Rates and the Employment Situation to name but a few.

Precious Metals

Gold is a great example of how fundamentals can play a major roll in the price of a commodity. The prices of gold, silver, platinum, palladium and other commodities are determined, both in the intermediate term and in the long term, by fundamentals of supply, demand, and inventories.

The gold prices can be influenced by many variables that include war, fabricator demand, expected inflation, return on assets, and central bank demand. For precious metals, generally low price means low production, and high prices result in high production.

Energy Trading

Basic fundamentals such as war, deregulation, climate changes and environmental factors can have a huge impact on the price of oil, heating oil, natural gas and unleaded gasoline.

I actually listened to a very interesting talk on the correlation between how many barrels of oil you can buy to an ounce of gold and how the difference between them if plotted as an average can give a great indication of the future price of gold.

Fundamentals could be summed up as an attempt to get a handle on the supply/demand of an instrument by looking at what drives that particular market.

If a fundamentalist can find something out of sync (disequilibria), then there may be a chance to profit.

I have been following news announcement for the last four or five years. I started getting really interested in tracking how the news affected the market around 2004 and actually developed a whole trading model around economic announcements.

I don’t want to go into a whole course at this point of how news can affect your market but here are some ideas. In the table below (Fig.6) you can see a little excel sheet I started in 2004. I started to track how economic announcements moved the Forex market when they are released:

Column A – Is the date
Column B – Is the instrument I was trading
Column C – Was the country that released the news
Column D – Was the name of the announcement
Column E - Was the early grading I gave to the announcement
Column F – Was how much I made trading the announcement.
Column G – Was how long it took to make a predetermined target
Column H – Was how big the move was in a predetermined time
Column I – Was comments I made about the move

Fig. 6

	A	B	C	D	E	F	G	H	I
1	Date	Pair	Country	Announcement	Grade	+/-	Minutes	Move	Comments
2	20-Jul-04	USD/CAD		Interest Rate	A	15			
3	20-Jul-04	EUR				-13			
4	27-Jul-04	EUR	US	Consumer confidence/New home sales	B&C	24			
5	29-Jul-04	EUR				6			
6	30-Jul-04	EUR			B	18			
7	02-Aug-04	GBP		PMI	B	18	00:31	34	
8	02-Aug-04	EUR		ISM Index	A	-10	00:05		Whipsaw
9	02-Aug-04	EUR		ISM Index	A	-10	01:45		To long
10	04-Aug-04	EUR	US	ISM Index Non Manufacturing Index	B		00:30	25	Whipsaw
11	05-Aug-04	GBP	GBP	Interest Rate	A	-10			Whipsaw
12	05-Aug-04	GBP	GBP	Interest Rate	A	14	00:03	24	
13	06-Aug-04	EUR	US	Non farm payroll/Unemployment rate	A&A	20	00:01	200	
14	09-Aug-04	GBP	GBP	ODPM House Prices	B		00:30	20	
15	10-Aug-04	GBP	GBP	RPI m/m (Jul)	B	16	00:02	30	
16	10-Aug-04	EUR	US	FOMC US Interest rates	A	8	00:03	33	Bit jumpy/got wrong time
17	11-Aug-04	GBP	GBP	Unemployment	B	-10	00:03	10	Whipsaw
18	12-Aug-04	EUR	US	Retail Sales ex Autos (Jul)	A	3	00:02	14	Big move before/choppy
19	17-Aug-04	EUR	US	CPI m/m (Jul),CPI Core m/m (Jul),CPI y/y (Jul),CPI Core y/y (Jul	B All	10	00:02	33	
20									
21					Total	99			
22					Average	6.2			
23					Wins	11			
24					Loss	5			
25					**W/L %**	**69%**			
26									

My news model has become quite complicated now but as you can see in just under a month I made 99 pips with a 69% hit rate. Not bad considering most of these moves only lasted five or ten minutes.

The point is, start to keep track of the news or announcements that move your market. You can develop a whole trading strategy around it.

Technical Analysis

> ***It requires a very unusual mind to undertake the analysis of the obvious.***
> ***Alfred North Whitehead (1861 - 1947)***

Technical analysis is the study of market action, mainly through the use of charts and indicators to forecast the future price of a security. There are three main points that a technical analyst applies.

A. Market action discounts everything. Regardless of what the fundamentals are saying, the price you see is the price you get.
B. The price of a given security moves in trends.
C. The historical trend of a security will tend to repeat.

Of all of the above points, a technical analyst is most interested in point A. It is also important for you to understand this point, as it is the basis of our approach to trading. I will cover “another” way later.

When you look at the price of any financial instrument as a technical analyst you believe that is the true value of the instrument as the market sees it.

Using a technical approach, you believe that all the factors that effect price, including, fundamental, political and psychological have all been built into the price you see.

This means that anything that can affect the price of a security has already been allowed for by the market participants. Technical analysts look at charts the same way a doctor would look at x-rays. They examine the charts for information on the future direction of the markets.

I am not going to go into the basics of technical analysis in this book because it is covered in one of the bonuses that you got when you bought the course. Just refer to the bonus “Trading For beginners” to learn more.

Another Way

It is our choices...that show what we truly are, far more than our abilities.
J. K. Rowling, Harry Potter and The Chamber of Secrets

So do you have to be a fundamentalist or a technical trader? Not necessarily. There is a another way. You can mix them both. You can be a technical trader but take heed of what is happening fundamentally in the market you are trading.

Think of it like this. Imagine watching the trailer of a great movie. You would have an idea of what the movie was about but if the movie "maker" did their job you would still be guessing. You have to watch the whole movie to know what happened.

It's like that in trading. You have to see the whole picture. You have to have some idea of what's happening in the world by keeping up-to-date with the news. You have to know when the major economic indicators are going to be released and you have to know where your next time frame up trend is.

That's why so many traders fail. It's just too much work for them. I bet if you asked any professional trader his opinion on the U.S. economy, the Gold price or Oil price he would at least have an opinion on the subject because it's his job to keep up-to-date.

Where's The Beef

> ***God gives every bird its food, but He does not throw it into its nest.***
> ***J. G. Holland***

It's time to get down to the nitty-gritty of the course. This is where you have to stop scrolling down the pages as fast as your little index finger can roll the mouse and pay attention.

In the pages that follow we are going to start laying the foundation of different ways you can approach the markets.

Broadly speaking there are three main ways traders will trade a market:

1. Trend following
2. Breakout
3. Reversal

We will look at each of them in detail.

Trend Following

Before I get going on this, it is important to realize that there is no such thing as a single definition of a TREND. A trend can be anything. It just depends on what a trend means to you. It might be three one day bars, it might be a succession of peaks and valleys made up of hundreds of bars on a monthly chart or it might be a sudden push made up of a few bars on a tick chart.

Trend is relative to your perspective in the market.

Generally speaking a trend is defined as follows:
Uptrend – A serious of higher peaks and higher valleys (see Fig. 7 below).

Fig. 7

Downtrend – A serious of lower peaks and lower valleys (see Fig. 7.1 below).

Fig. 7.1

When speaking about trend we must also mention time frame. Some traders can only trade part time because they have full time jobs and therefore tend to watch daily, weekly and monthly charts.

Some traders like to just keep an eye on the market and will tend to watch 1-hour, 4-hour and daily charts.

And yet other traders like to be very active during the day and may watch anything from a tick chart up to a daily chart.

The reason I mention this is because the time frame you trade will determine the trend for you.

The trend might be down for a trader who looks at weekly charts and up for a trader who trades 5-minute charts. In fact, for a 5-minute trader it will probably go through numerous ups and downs during the week but to the trader who looks at weekly charts it's all the same direction.

Have a look at Fig. 7.2 below. You can see that on the weekly chart on the left there have been five down bars (candlesticks), yet on the 5-minute chart on the right there was in fact an uptrend.

Chart 7.2 AUD/USD – Weekly on the left and 5-minute on the right.

One other point I want to make is that there is no best time frame. No one time frame is a magic time frame that makes more money than another time frame. You can make just as much money on a 1-minute chart as you can on a monthly chart and vice versa.

The advantage of a smaller time frame is that you have a better use of margin e.g. if you are trading a 5-minute chart and are closely monitoring the chart you can have much tighter stops.

As the name implies, trend trading simply means identifying a trend and jumping on. Visually a strong trend should be easy to spot. If you look at a chart and you can see that the market is moving up then obviously it is in an uptrend. If you look a chart and you can see that the market is moving down, then you are in a downtrend.

There is only one problem with this little scenario. Remember what I said about seeing the big picture. In order to really have a good idea where the overall market is going you need to look at more than one chart.

This can be controversial as lots of traders only look at one chart and will argue that this is all you need and for some that may be true. The problem is that unless you are looking at other charts you don't know where the main trend is.

Imagine you are at the beach and the tide is coming in. You get a spade and dig a trench that zig zags a few times and then points back to the sea. The water comes into the trench, follows the zig zag then heads back to the sea. The problem is that no matter how many trenches you dig you will never stem the direction of the tide. It is either in or out. If the tide is coming in you can dig trenches until you go blue in the face and you won't stop it. That's why it is always safer to trade in the direction of the trend.

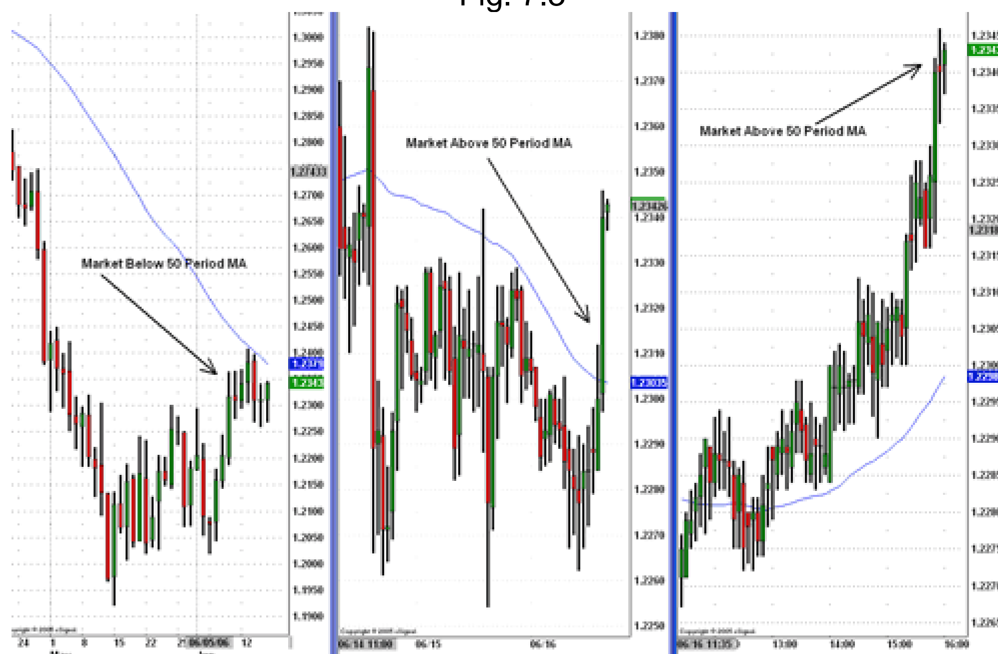
Here's another analogy – Imagine a river running down a mountain. Even though the river eventually gets to the lake or sea, it takes many twists and bends. It might backtrack for some time and then continue on its way. When it backtracks it might even branch off to another smaller channel before returning to the previous track and then to the main river.

Regardless of where it twists and turns it always eventually gets back on track in the direction of the flow of the river.

Trading is like that. If the main trend (river) is headed down then it is dangerous to trade against it.

As an example, look at Fig. 7.3 below. The chart on the left is a daily chart, the one in the middle is a 1-hour chart and the one on the right is a 5-minute chart. The blue line is a simple 50 period moving average.

Fig. 7.3



You can see that on the daily chart the market is below the 50 period moving average. On the 1-hour chart the market is above the 50 period moving average and on the 5-minute chart the market is above the 50 period moving average.

Now as an experienced trader you can probably duck in and out of trades as long as you know what you are doing but that can be dangerous for new traders.

In this example the trader would either be a 5-minute trader or an hourly trader. In other words you might trade the 5-minute chart and use the 1-hour and daily chart as confirmation that you are in the right direction. You might also be an hourly trader who uses the daily chart as confirmation of the trend and uses the 5-minute chart for your entries and exits.

The point of this is that you should wait until all three time-periods are either above or below the 50 period moving average before you consider making a trade.

This is just one way to get a feel for the overall direction of the market. This one little technique is worth the amount you paid for the course. If you can just be patient enough to wait for the three time frames that you are monitoring to either be above or below the market at the same time you will improve your trading 100%.

In Fig. 7.3 the example I used was a 5-minute, 1-hour and a daily chart. You could use any three time period as long as there is a reasonable difference in time frame. If the time frames are too close together you will be looking at the same thing.

I have used a 1-minute, 5-minute, and 30-minute setup. I have also used an1-hour, 4-hour and daily chart setup.

I have also use a 4-hour, daily and weekly chart set up. Use any time frames you like as long as there is a decent gap between them.

The secret of being a good trend follower is being able to identify a trend at an early stage. To do this you have to look at the biggest time frame of your three time frames.

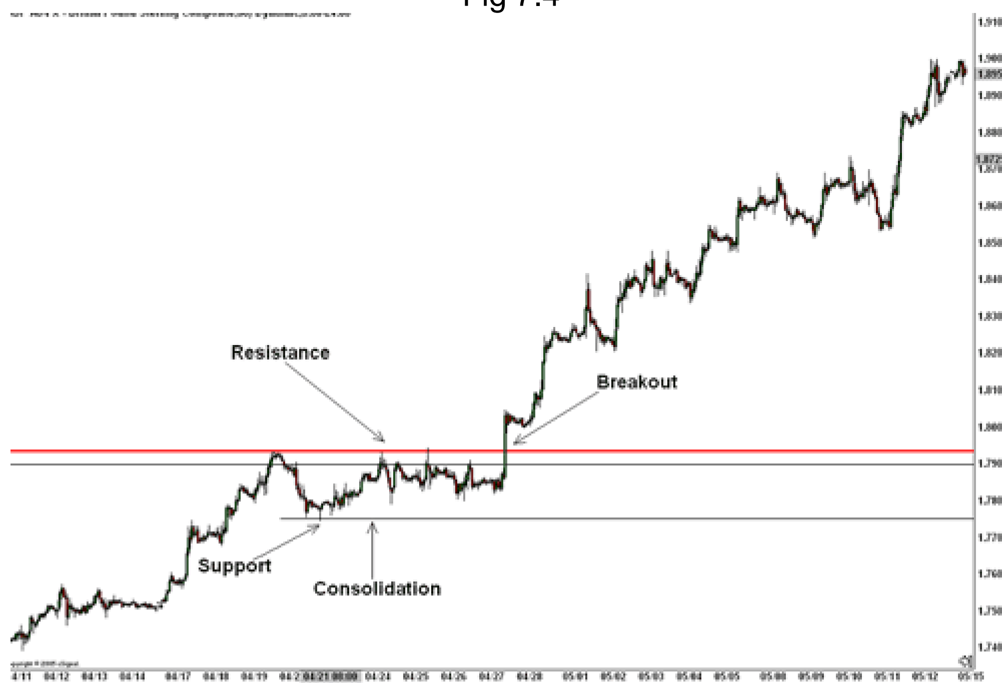
A good trend should start with a good set up. It is too easy to get caught up in a complex method or system. Remember, it doesn't matter what approach you take to the market, the market can only do one of three things:

- Go Up
- Go Down
- Go sideways

Look at Fig. 7.4 of a daily chart of the GBP/USD. It is such a classic move that it is worth studying. The more you can identify and recognize a good move, the better the chances you have of becoming a good trader.

If you look at the red line marked resistance, you can see that the market tested this area three times before but couldn't break through. This is your first clue. The more a market tests an area without breaking through, the more likely the move will be explosive when it does happen.

Fig 7.4



In this particular case, the GBP was unable to break the resistance area for months. Every time a market approaches a major resistance or support area you should pay careful attention. In a situation like this, the market will normally do one of two things:

1. Break through previous resistance, in which case you could expect a big move.
2. Fail at this level and make its way back down.

Let's look at each scenario. If the market breaks out, we can expect a big move because it has tested this area before and a push above the resistance area will take out a lot of stop loss orders. If this happens we should be ready to jump on and hang on in there until we have reached our target. If we missed the initial breakout then we should be ready to take advantage of any pullbacks to get in.

The second scenario is that the market fails to break through previous resistance and starts back down. If that is the case then there is nearly always an area of consolidation. If the market passes back through support then there is an opportunity to go short.

The consolidation is often the key to the start of a new trend. If ever you see a prolonged period of consolidation on a chart, monitor it carefully. This is often the area where trends are born.

One of the best trend indicators is the Average Directional Movement Index (ADX). This indicator tracks the strength of a trend. In Fig. 7.5 below I have the ADX set to 14. When the ADX drops below 25 start to watch how the market behaves. What you are looking for is for the ADX to drop below 25 and then start back up.

Fig. 7.5

In Fig. 7.5 you can see that the ADX dropped below 25 and then broke through the 25 level. At the same time the market came up and tested the resistance level but wasn't able to punch through.

The ADX then dropped back below the 25 and slowly started making its way back up through the 25 level. Just before the market broke out the ADX passed through the 25 level. At the time of the breakout the ADX was already above 25. This is a good indication that this was the start of a trend.

At this stage I am just describing what a trend trader is: someone who is trying to identify a trend at the earliest stage possible.

Breakout Trading

Breakout traders come in all sorts of shapes and sizes. Breakout traders, as the name implies, are looking for a market to break out of a defined area. That might be a support or resistance area, a weekly, monthly or yearly high or low or a chart pattern.

Most breakouts fail so the secret of successfully trading a breakout is to identify a good candidate and limit the losses so that even though there could be more losses, the winners more than makes up for them.

Let's look at Fig. 7.6, remember as a breakout trader you are still looking for high probability trades with low relative risk. The bottom of the consolidation area was 1.7061 and the top (resistance) was at 1.7935. That's a range of 874 pips.

The breakout trader would do one of two things:

1. Have an entry order just above 1.7935 to take him into the market.
2. Wait for the close above resistance and enter on close.

Fig. 7.6

So the breakout trader knows where he has to get in but where does he place his stop. We'll have a look at the line marked support. That is sitting at 1.7750. If he has an entry order above 1.7935 and a stop just under 1.7750, he is risking 185 pips.

As a rule of thumb a good breakout will move at least the same amount as the range that it was in before the breakout. As you can see the range was 874 pips. So if you add the range to the resistance level you have a target.

Now you have an entry area, a stop loss and a target. He is risking 185 pips to make 874 pips or a 4.72 risk to reward. If he can maintain at least a 4.72 risk reward rate then he only needs to be right one in every 3 or 4 trades to make money.

As this is a daily chart the numbers are big but the same thing applies to a smaller time frame.

In the next example Fig. 7.7 you can see a consolidation area and four bull flags. A bull flag is just one of many chart patterns. Bull and Bear flags can be found in nearly all uptrends and downtrends.

To begin with, the breakout trader would have entered on the break of consolidation. He could then take some profits as the trend progresses and reenter on every breakout of the bull flags.

Like all traders you get different risk types. If the breakout trader is aggressive he would enter on the break of the top channel line of the bull flag. If he's was a conservative trader he would watch the break out and wait for the market to close above the previous high (confirmation) before entering.

Fig. 7.7

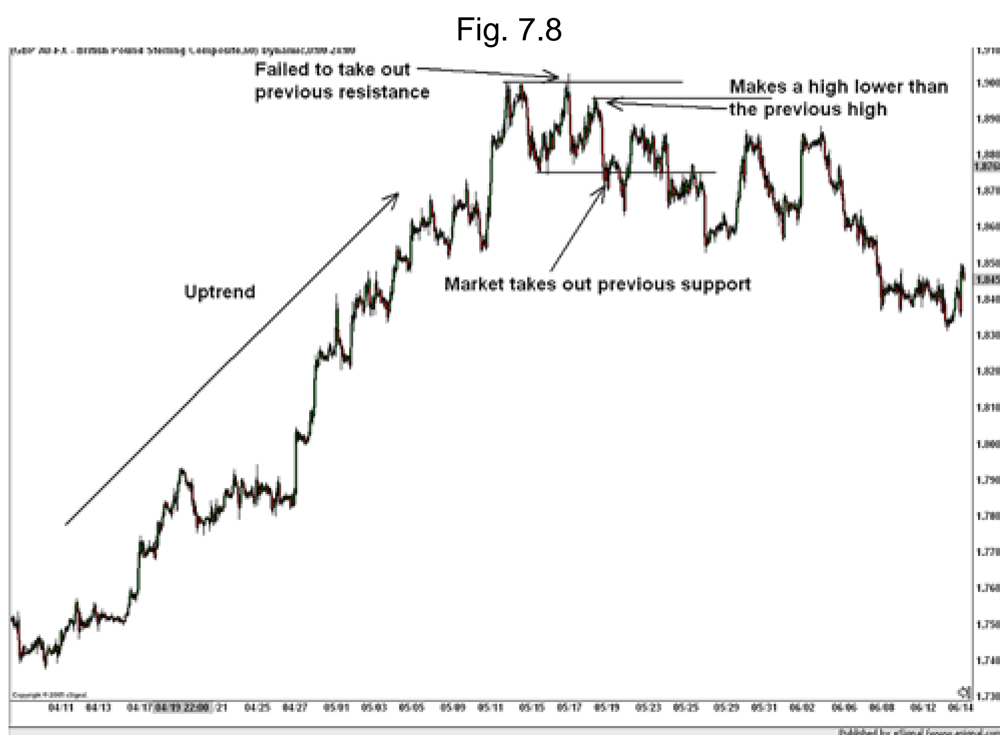
Reversal Trading

Reversal trading can be a bit harder to master because you have to know when the trend has ended and is about to reverse.

In Fig. 7.8 you can see that there was an uptrend. The market then stalled. It tried to take out the previous high but couldn't. It then started down and formed a high lower than the previous high and eventually took out previous support.

The fact that the market couldn't take out the previous high is the first clue that the market is weakening or at least consolidating. The final clue is that the market took out the previous support. When that happens the market is reversing or at least retracing.

Fig. 7.8



Now let's look at Fig. 7.9. The indicator at the bottom of the page is MACD (moving average convergence divergence). You can see that MACD started to turn down before the market did. You can see that by the time the market came up to test resistance for the third time, MACD had already made lower peaks. This is an indication that the market is turning. When an indicator is going in one direction and the market is going in the opposite direction – that is called diversion.

Fig. 7.9

Fig. 7.10 is another example of bearish divergence using RSI (Relative Strength Index) this time to help identify when a reversal is setting up.

Fig. 7.10

Quick Summary

We have now looked at the basic ways of trading the markets. They are just examples and I could spend the rest of this book just going into ways you could trade these three basic approaches. I just want you to get an idea of how some traders approach the markets.

Regardless of which approach you take you will find it infinitely improved if you use the multiple time frame approach e.g. have your three charts up, set at different time frames and apply one of the techniques being aware of where the trend is.

Trading Plans

> ***He who every morning plans the transaction of the day and follows out that plan, carries a thread that will guide him through the maze of the most busy life. But where no plan is laid, where the disposal of time is surrendered merely to the chance of incidence, chaos will soon reign.***
> ***Victor Hugo (1802 - 1885)***

Now we get to some of the good stuff. On the pages that follow I will outline some of the best trading plans I have come across that you can either use or adapt to suit your trading style.

With all trading plans I want you to use a checklist before you even think about trading the plan.

Points	Checklist	Yes	No
1	Has there been any significant general news.		
2	Is there any significant economic news out today.		
3	Am I prepared to trade today - Have I done my homework.		
4	Am I emotionally OK to trade today.		
5	Is there a great setup.		
6	Do I know where I want to get out of the trade if I enter - Target.		
7	Do I know where to place my stop loss.		
8	If there is a setup, will the trade be within my risk parameters.		
9	Do I have sufficient time to place the trade without being rushed.		
10	Is there any big economic announcements in the next few days.		

Let's just look at these points:

1. Has there been any significant general news – It is important that you have some kind of grasp on what is happening in the world, just in case a war is about to start. Some of the best places to check on the news are:
   http://www.businessweek.com
   http://news.com.com
   http://abcnews.com
   http://wsj.com
   http://www.nytimes.com
   http://www.nasdaqnews.com
   http://www.bbc.co.uk
   http://www.cnn.com
   Just spend around ten or fifteen minutes checking if there has been anything significant that has happened in the last 24 hours.
2. Is there any significant economic news out today – This is a biggie. You have to know if there is a big economic release every day you trade. As part of the course you can refer to the "Little Book of Economic Indicators" to help you decide how important the release is but you should also check out the following websites:
   http://biz.yahoo.com/c/e.html

   http://fidweek.econoday.com/

   http://www.briefing.com/Investor/Public/MarketAnalysis/Calendars/EconomicCalendar.htm

   http://www.bloomberg.com/markets/ecalendar/index.html

   http://money.cnn.com/markets/IRC/index.html

   http://moneycentral.msn.com/investor/calendar/econ/current.asp

   http://online.barrons.com/public/page/barrons_econoday.html

   http://www.fxstreet.com/nou/continguts/economiccal.asp

   http://www.marketwatch.com/tools/marketsummary/calendars/economic.asp?siteid=mktw

   Nearly all trading platforms provided by your broker will have the latest news for your market but it's a good idea to keep up with what's happening with the big picture. This should also only take ten to fifteen minutes.
3. Am I prepared to trade today - Have I done my homework – You should be checking your charts daily and know when a trade is setting up. You can't just sit down and immediately start trading. You have to have done your analysis and know when a trade is really ready.

4. Am I emotionally OK to trade today – You will have bad days just like everyone else. Maybe you had a fight with the wife or your boss or you just don't feel right. When you feel like that, don't trade. You should be relaxed, with nothing on your mind but the charts when you trade.
5. Is there a great setup – Note here I said great setup. You should only take the very best trades. If the trade looks so-so, then don't take it. All your indicators should be screaming at you that this is a good trade and your gut should also tell you that it is a good trade before you take it.
6. Do I know where I want to get out of the trade if I enter (Target) – Just as you should know where you are going to enter a trade you should know where you want to get out. You should have a predefined target in mind as you enter the trade.
7. Do I know where to place my stop loss – This is a "no brainer." As soon as you enter the trade you should know exactly where you want to place your stop loss.
8. If there is a setup, will the trade be within my risk parameters – Just because everything else is looking good on the checklist you still can't take the trade if it means placing your stop loss so far away that it means you are risking too much of your equity.
9. Do I have sufficient time to place the trade without being rushed – This may seem a little strange but I have been in the position where I have had an appointment just as the trade lines up. If you feel rushed or you know you are under the gun for time, just leave it. There will always be other trades.
10. Are there any big economic announcements in the next few days – Trading is about juggling a lot of information at the same time. If you are the type of trader that normally stays in a trade for a few days and you know there is a big economic announcement coming out the day after you enter the trade it might be better to just skip the trade or at least be aware that you will have to monitor the position carefully.

What follows is a collection of plans. Find one that suits your style of trading and work with it. Now think about what I just said - "work with it". Don't follow anything blindly. Test it and demo trade it before you do anything.

Before I get into the plans I want you to read a couple of lessons by two professional traders. The first is called "The Free Trade Strategy" by Bill Poulos. It provides very good advice that can be applied to any trading plan. Bill is a seasoned trader who has been around long enough to know what he is talking about. For more information on Bill you can visit his website here.

The “Free Trade” Strategy

by Bill Poulos

Besides money/risk management, I believe this is one of the most important components of a good trading method. It should go without saying that as soon as you enter the market with a new position, an initial stop order should be entered to protect the position against an adverse move in the market. If such a move occurs, as is often the case, you want your position liquidated and out of the market with a minimal loss.

The consequences of failing to do this are that you will not be successful at trading, period. In fact, every trade you put on, you should plan to lose, so that you are sure to place your stop loss order. Otherwise, what would have been a small loss turns into a big loss, throwing the entire risk/reward ratio out of kilter against you.

That being said, where should the stop be placed? The short answer is, “Where you don’t expect the market to go”; or, more specifically, where the assumption in putting on the trade is no longer valid. For example, if a long position was entered into above a swing low signifying support in an up trending market, an initial stop could be entered below the swing low because if the market does go there, support (as defined by that swing low) would have failed, and there is no longer any reason to be long the market – so get out! Don’t wait around for it to come back in your favor because the odds are against it.

If the market goes in your favor once the initial stop is in place, then you need a set of rules that will allow you to exit the market profitably. This poses a real dilemma. If you exit too soon, you will secure a small profit, but miss out on all those big moves that occur (and the big profits that go with them). On the other hand, if you wait too long to exit, the market may reverse and take away all of your open profits and even put you into a loss position.

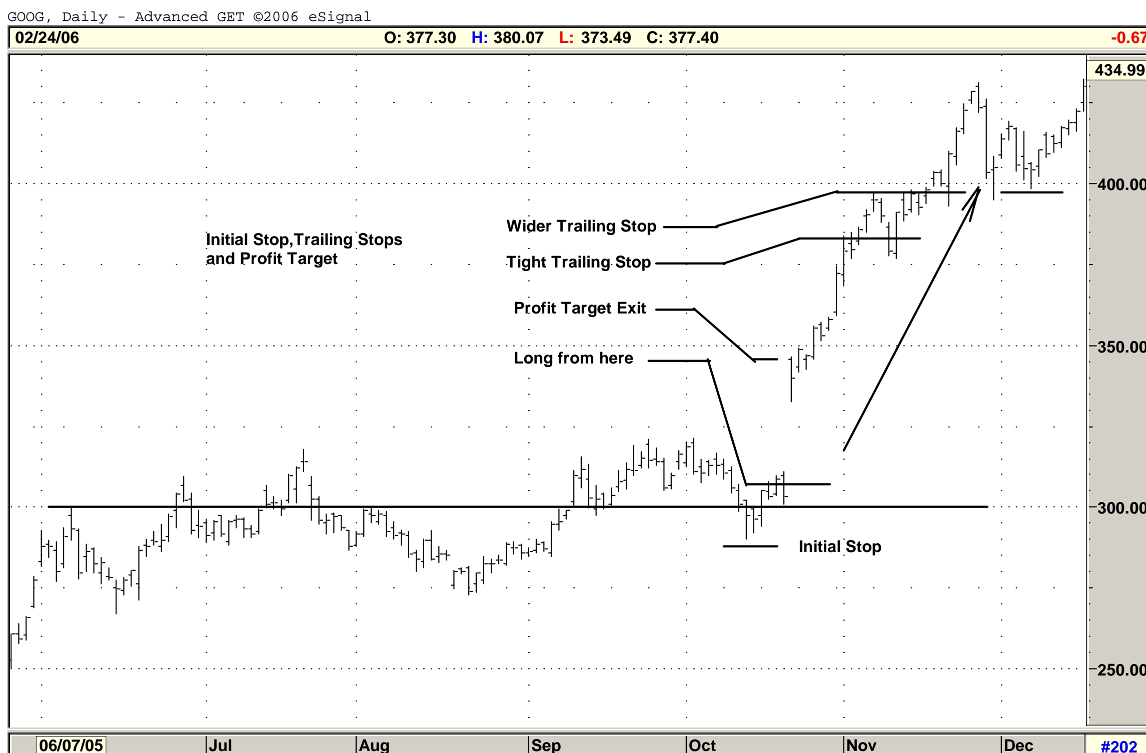


Fig. 8 – Initial Stop, Trailing Stops, & Profit Target Example

So what do you do? Well, the first thing is to realize that there is no method that can forecast whether or not a particular move will:

- Go against you immediately
- Go up only a little before going back down
- Go up a lot in your favor

For example, after you enter a long trade in an uptrend, there's absolutely no way to predict what will happen next (contrary to what the so-called "gurus" tell you). Because of this, you absolutely need an exit strategy that is effective for all outcomes.

The following is the very best exit strategy that I believe possible for swing traders. I call it the "Free Trade" strategy. It is a strategy that scales out of a trade in three steps. This strategy is first and foremost about reducing the risk in the trade.

1. Step one is to move the stop to breakeven as soon as possible. The way I do this is to cover 1/3 of my position at a specific profit target and then move the stop on the remaining 2/3 of the position to breakeven. The profit target is modest, but enough to make the trade worthwhile and the specific level is also dependent on the overall method being used. Once that initial profit target is hit and the stop moved to breakeven for the remaining 2/3 of the position, we virtually have a "Free Trade". We are out with a quick profit, we still have 2/3 of our position on for the potential for much more profit and we have reduced the planned risk in the trade down to zero – a "Free Trade". I really like the way that sounds. This reduces risk in the trade as soon as possible and now I am positioned to ride the market in my favor if it chooses to do so.

2. The remaining position is then protected by two levels of trailing stops. For the second 1/3 of the position, I use a trailing stop that is fairly tight, below a recent low or other close-in support point that most of the time when it is hit will result in a profit level greater than the first 1/3 of the position. This strategy gives the market a chance for a quick run up generating profits that we want to protect with a fairly tight trailing stop.

3. The last 1/3 of the position is protected by a trailing stop that gives the market more room to fluctuate without being shaken out of the trade before the trend reverses. This stop is therefore set at progressively higher support levels that, when eventually violated on the down side, will trigger the stop and exit that last 1/3 often times at a profit greater than second 1/3 of the position.

With this strategy, you are prepared to take advantage of the market after entering a trade no matter what it does.

Good Trading,

This next strategy by Neal Hughes is also a great insight to how a professional trader thinks. You can visit his website here.

"Taking Profits" Strategy

by Neal Hughes

So much time is spent on entering a trade. Today I want to focus on some exit strategies. This is not a full Fibonacci course, so if you don't understand the basics I suggest that you visit my website for help with those aspects.

Human nature makes trading very challenging. Sometimes you want to exit a trade too quickly when it goes against you, and to cling on to a winner too long. Too often a winning trade will reverse, taking back most of your profits, or even going into a loss. On the other hand if you exit too soon, you risk missing some big profits. You may find that you're sitting on the sidelines while the market continues well beyond your exit. I want to show you how to bank those profits before they turn against you.

Fig. 8.1 First look at this FOREX chart (JPY hourly chart).

Let's imagine that you were clever (or lucky) enough to enter long near point "A". You're feeling pretty good when price reaches "B". So good that you don't want to exit, because the up-thrust just before "B" give the impression that this market wants to go further.

Before you know it, the market reverses and heads towards "C". Right at "C" you get scared and bail out with a little profit. Not much profit compared to exiting at point "D" or even at "F".

You exit near "C", and feel relieved until you see the market heading (thrusting) up to point "D". You stop kicking yourself long enough to enter when it breaks above "B", just a little before the high at "D".

Soon after your entry near "D", the market retraces to "E", and on the way breaks below the high of "B". Breaking below the high of "B" feels scary because you're thinking this chart could be back at "A" in a flash. So you exit at "E" licking your wounds with a loss in this trade.

You start to notice more frustration now, when you enter somewhere between "E" and "F". You're feeling good near "F", but then the chart dives to "G" and you're stunned! This is a losing day for your account, and it's beginning to hurt.

By this time you feel like the whole market is watching your trades and they're doing exactly the opposite of what you are doing. You start thinking that they wait for you to enter before they slam you and empty your account.

You have wasted your emotional capital; you don’t want to trade any more. You don't have the stomach to consider shorting the rally after "G" to take profits at "H".

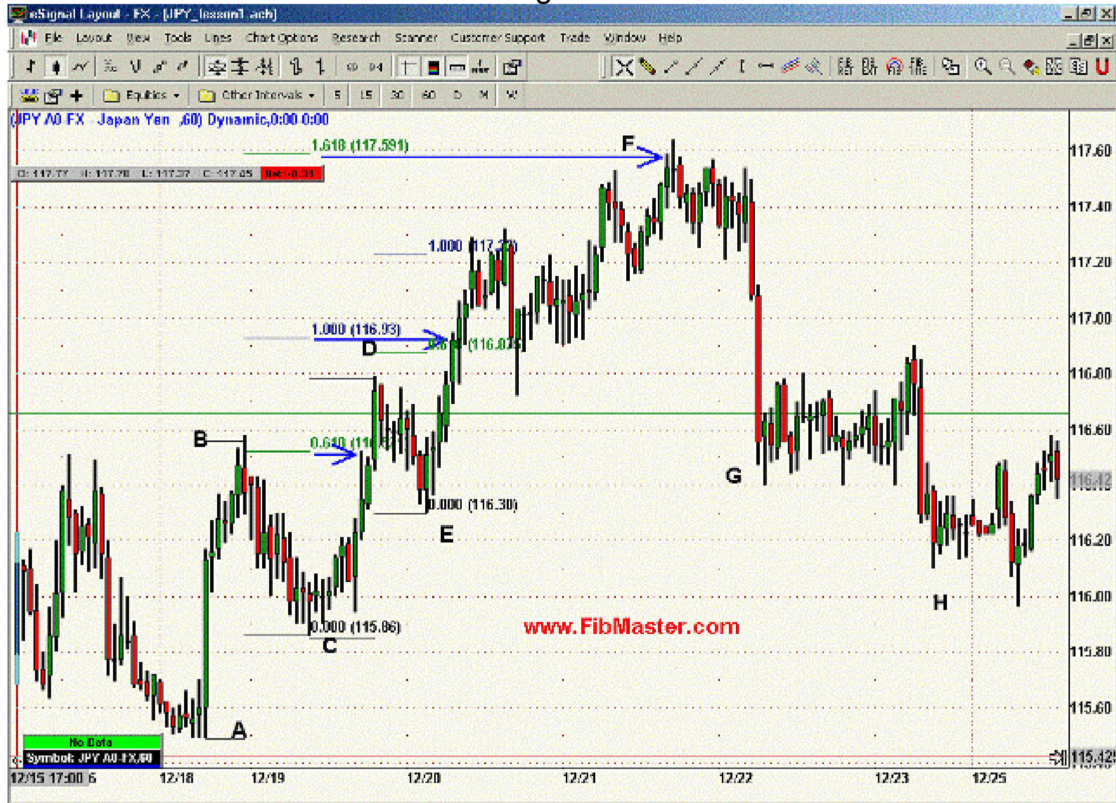
There must be a better way!

Banking those profits.

You should seriously consider using profit targets to improve your trading performance. There are several ways to do this; my preference is to use Fibonacci techniques.

On the following chart (see Fig. 8.2.), I have added a Fibonacci expansion using points “A, B, C”. This provides us with three profit targets. They are at 116.52, 116.93, and 117.59 (see the blue arrows). These values represent 61.8%, 100% and 161.8% of the distance between point “A” and point “B”, when measured from point “C”. See my website for more details on how to calculate probable market turning points.

Fig. 8.2



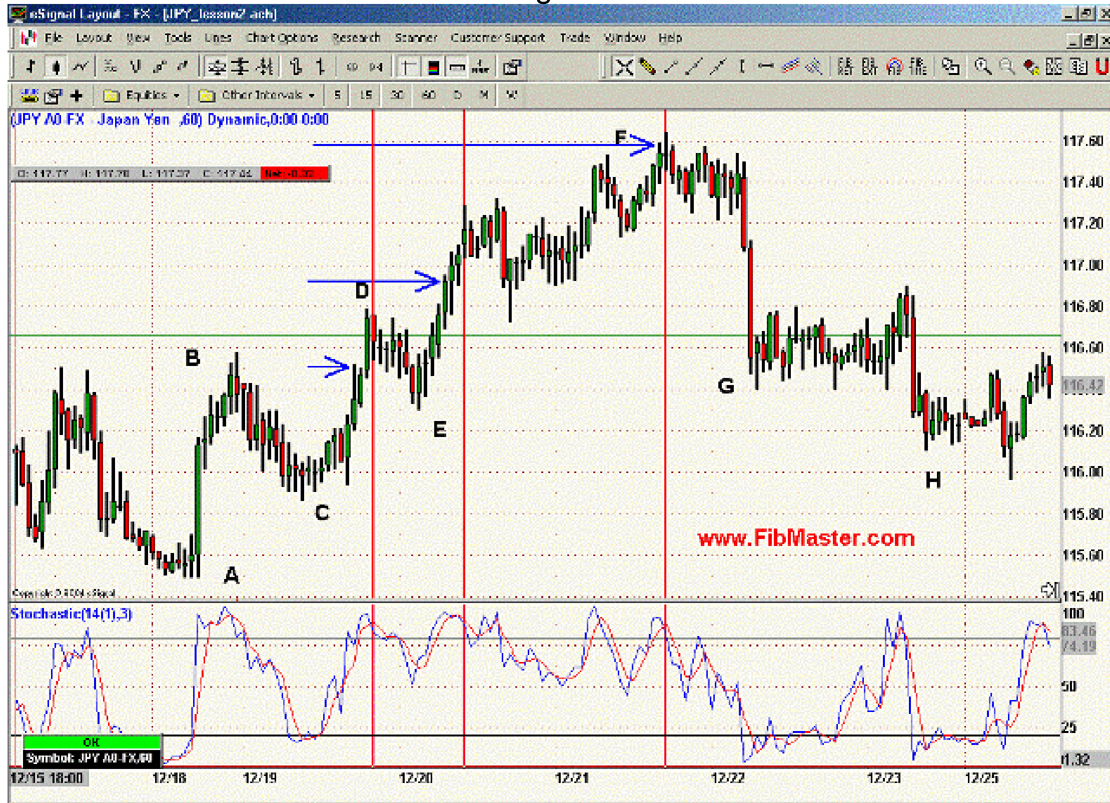
If I add another Fibonacci expansion using points "C, D, E", then two more profit targets are added, at 116.87 and at 117.22. I have not added those studies to the chart, in order to keep things simple for now. You will notice the 116.87 target is quite close to the profit target at 116.93 in the above paragraph. And the 117.22 target is remarkably close to the swing high at 117.32 which is between E and F. We'll ignore those for simplicity, just remember that Fibonacci is excellent at predicting probable turning points.

The trick with Fibonacci is that the market sometimes blows right through a profit target. So what do you do then? Simple - you stay in the trade! But sometimes the market reverses shortly after a profit target.

Sometimes the market respects a certain Fibonacci level, sometimes not. Some Fibonacci levels are "stronger" than others. Advanced Fibonacci techniques are able to help determine which have more validity, but that is beyond the scope of this lesson. What mechanism could you use to exit the trade?

One practical method of timing a trade is to use an oscillator. Another is to use a moving average. When an oscillator shows a decline of momentum, or when price crosses a moving average, you could exit the trade. Let's explore the "oscillator" option in the following chart.

Fig. 8.3



In Fig. 8.3, I have removed the Fibonacci studies (less clutter), leaving the blue arrows for profit targets. At the bottom I have added the default Stochastic per E*Signal charting software. I have added a red vertical line whenever the Stochastic "fast" blue line crosses the "slow" red line just after price rises above the Fibonacci target. If you exited when price reached those vertical red lines, you'd be a happy trader!

Already you can see the potential of using profit targets with an exit trigger.

You may want to research the following:

- Possibly exiting a partial position at each profit target.
- Consider entering long again on the dips, when the chart begins to rally again.
- Consider using multiple time frames, perhaps Fibonacci studies on the hourly chart, and exit triggers on 5-minute charts.

Neal Hughes www.fibmaster.com

Trading Plan # 1

Pivot Point Trading With A Twist

If you managed to get to this point and have read every single word so far, then the plans that follow should be a breeze. This is the first trading plan I want you to consider molding to your own style of trading.

Pivot Point Trading is actually an old form of technical analysis. It has been around a long time and I am sure it will be around a long time in the future.

It was originally used by floor traders who needed a simple method of keeping track of the direction of the market and potential buy and sell points.

It is a leading indicator unlike many of today's indicators. A leading indicator is an indicator that can be used to forecast possible price points before they get there. Although the concept is relatively simple, make no mistakes, many large institutions and traders take careful note of where the day's Pivot Points are.

Before I get into this particular plan, let me tell you how I discovered Pivot Points. Through a mutual friend I was introduced to a well-seasoned trader. He had been around for years and had heard it all before. He had gone through his apprenticeship at one of the top brokerages as an analyst and had made quite a name for himself forecasting everything from Gold to Forex.

After some maneuvering, I managed to set up an appointment with him. Even after I had arrived at his house he wanted to have a long talk before he would let me near his trading room. Well, after talking with him for some time he obviously decided that I wasn't a complete idiot and he took me to his Holy of Holies – his trading room.

The room was just like any other trader's; with clutter everywhere; the usual desktop toys; some old newspapers and books lying everywhere from the desk to the floor.

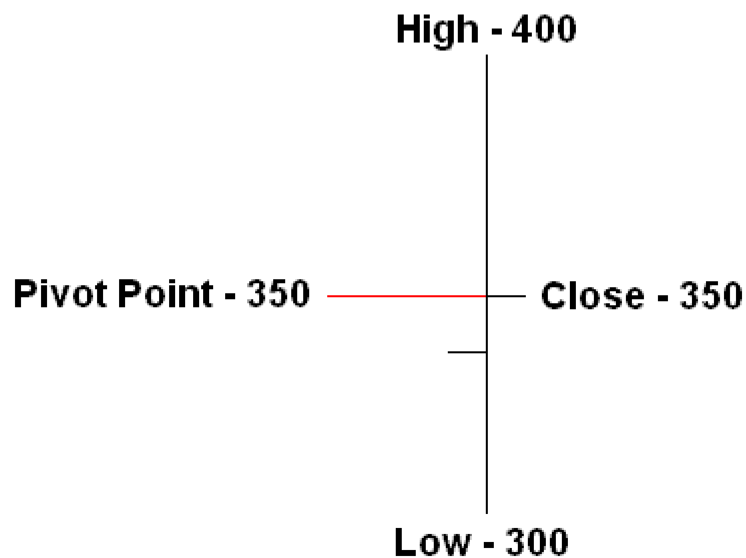
The surprising thing was what was showing on his monitor. It was a chart of the GBP/USD and unlike my own charts, it was surprising bare. At the time, I was used to having so many indicators on my charts that I sometimes had to think why I originally put them there.

Anyway, all that was drawn on the charts were 5 straight lines. I asked him what these lines were and he explained that they were Pivot Points. He grabbed a piece of paper from his printer and started to explain what Pivot points were. The actual Pivot Point was simply the sum of the High, Low, and Close divided by 3.

$$P = \frac{H+L+C}{3}$$

P = Pivot
H = High
L = Low
C = Close

Fig. 9



Example:
High = 400
Low = 300
Close = 350

$$P = \frac{400 + 300 + 350}{3}$$

Therefore P = 350
The most important thing about the Pivot Point is the relationship of the close to the range of the High and Low.

First Resistance

First Resistance (R1) is the first forecasted area of resistance. To get the R1 you take the Pivot Point times two and subtract the low.

R1 = (PX2)-L
Example:
P = 350
L = 300

R1 = (350X2)-300
Therefore R1 = 400

Second Resistance

Second resistance (R2); to get R2 you add the Pivot point to the High and subtract the low.

R2 = (P+H)-L
Example:
P = 350
H = 400
L = 300

R2 = (350+400)-300
Therefore R2 = 450

First Support

First support (S1); to get the first support level you take the Pivot Point times two and subtract the low.

S1 = (PX2)-H

Example:
P = 350
H = 400

S1 = (350X2)-400
Therefore S1 = 300

Second Support

S2 = (P-H)+L
Second support (S2); to get the second support level, subtract the High from the Pivot Point and add the Low.

Example:
P = 350
H = 400
L = 300

S2 = (350-400)+300
Therefore S2 = 250

You will see that in one of your bonuses (the Pivot Point Calculator) there are actually 3 resistance levels and 3 support levels. I don't use the third levels much but you can calculate them if you like using the Pivot Point Calculator.

I worked with this concept and eventually added my own twist to his method. There are also a lot of variations on the original Pivot Point calculations I have just described, including calculating the Open, High, Low and Close and then dividing by 4.

I know some traders also like to calculate the mid points between the different support and resistance levels but I found I just end up with a lot of lines and they tend to be minor levels.

Let’s just talk about when the open and close actually is. Some markets are straightforward in that they have a predefined open and close. Other markets like Forex operate 24 hours so they do not have a predefined open and close.

Although the Forex market is 24 hours, it trades in sessions e.g. the European session the, U.S. session and the Asian session. These sessions are based roughly on the opening time of their main stock markets as that is when there is the most activity.

If you are based in Europe, you might want to use the rollover time of 10pm GMT as the end of one day and the start of the next. After 10pm the market is quiet and you won’t go far wrong by just using midnight as the end of the day.

If you are in the U.S., then most traders use 5pm EST as the end of one day and the start of the other for Forex.

If the market you are following has odd hours such as 20 hours then just use that 20-hour period as a day.

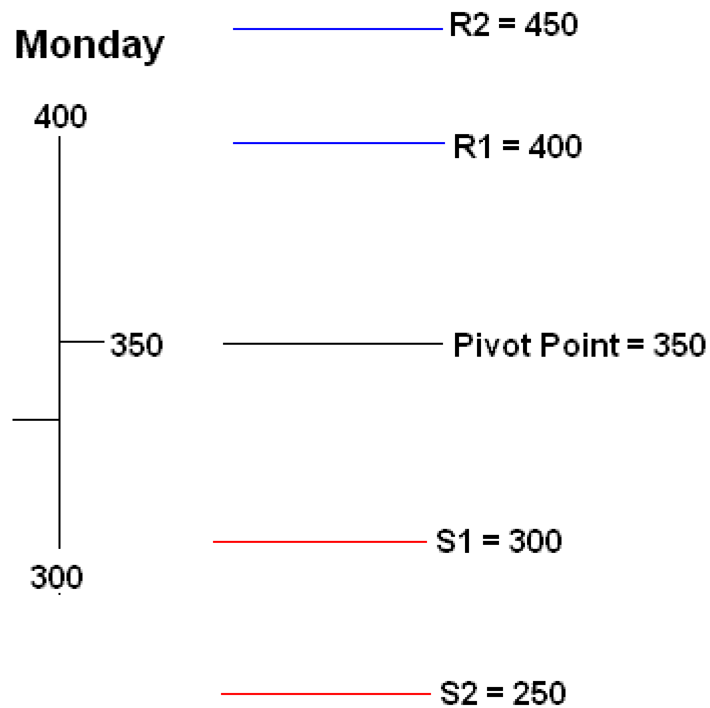
I know some traders get caught up on the exact start and close of the day but don’t be overly concerned. All you are trying to achieve is to find the High, Low and Close of the previous day’s action.

The day doesn’t need to be 24 hour or 8 hours. Just measure the High point, Low point and Close of the action on the previous day of the market you are trading.

Let’s say that today is Tuesday. The way to find the Pivot Points that you are going to use for today would be to take your calculation from Monday.

Fig. 9.1

Tuesday



In Fig. 9.1 above, we used the same numbers as our previous examples. The High was 400, the Low was 300 and the Close was 350. This gave us our Pivot Points for Tuesday.

Have a look at the chart below of a 5-minute chart of the GBP/USD.

Fig. 9.2

You can see that the Pivot Point and the R1, R2, S1 and S2 have been marked. These calculations were taken from the day before. The market opened and found support at S1, then rallied up to the Pivot level. The market actually tested the Pivot Level twice before making its way back down to S1 and then eventually passed through S2.

Now, so far we have only talked about Pivot Levels taken from the previous day but you don't always have to use a day to take measurements of your Pivot points. You could use the previous week, month or Year.

You use the same calculation for longer time periods e.g. if you are using monthly bars then just use the previous months High, Low and Close to do your calculations.

Let's look at the monthly Pivot first. You can see in the example below that we are presently in July, therefore we calculate the Pivot point for July using Junes High, Low and Close.

High = 1.8880
Low = 1.8091
Close = 1.8494

Therefore the Pivot Level for the whole of July is 1.8488.

In Fig. 9.3 below, you can see a monthly chart of the GBP/USD. Because the Pivot Points for each month are joined together, it creates a continuous line just like a Moving Average.

Fig. 9.3

Now let's take this one stage further. We know that the monthly Pivot Point for the whole of July is 1.8488. If you put this Pivot Level on a daily chart it would look like this.

Fig. 9.4

OK, So far so good. But we still have a ways to go. We have the Monthly Pivot Point marked on the daily chart and now we are going to put the weekly Pivot Point on the daily chart as well. The High was 1.8599, the Low was 1.8177 and the Close was 1.8593. Therefore the weekly Pivot Point was 1.8456.

The weekly Pivot Point would look like this on a weekly chart.

Fig. 9.5

The weekly Pivot Point displayed on a daily chart would look like this.

Fig. 9.6

You can see in Fig. 9.6 above that the black line is the monthly Pivot Point and the blue line is the weekly Pivot Point.

One more stage before we get down to the good stuff. In the next chart, Fig. 9.7, you will see three lines: the monthly Pivot Point: the weekly Pivot Point and the Daily Pivot Point.

Fig. 9.7

In Fig. 9.7 above you can see a daily chart with the monthly, weekly and daily Pivot Points marked.

Why is this important?

Well, think back to the Dow theory (read your bonus “Trading For Beginners”). In order to trade effectively you have to have some sense of where you are in the overall trend. In these examples:

- The monthly Pivot Point is your long term trend
- The weekly Pivot point is your intermediate term trend
- The daily Pivot Point is your short term trend

If the weekly Pivot Point is above the monthly Pivot Point then the trend is up. If the weekly Pivot Point is below the monthly Pivot Point then the trend is down.

For the maximum chance of success we want the weekly Pivot Point to be above the monthly Pivot Point and the daily Pivot Point to be above both the monthly and weekly Pivot points for long trades.

For short trades we want the weekly Pivot point to be below the monthly pivot point and the daily Pivot Point to be below both the monthly and weekly Pivot Points.

If the daily Pivot Point is in between the monthly and weekly Pivot points then be more cautious. You will generally be in consolidation when this happens and it will be hard to find a decent trade. Knowing “when not to trade” is just as important as knowing “when to trade.”

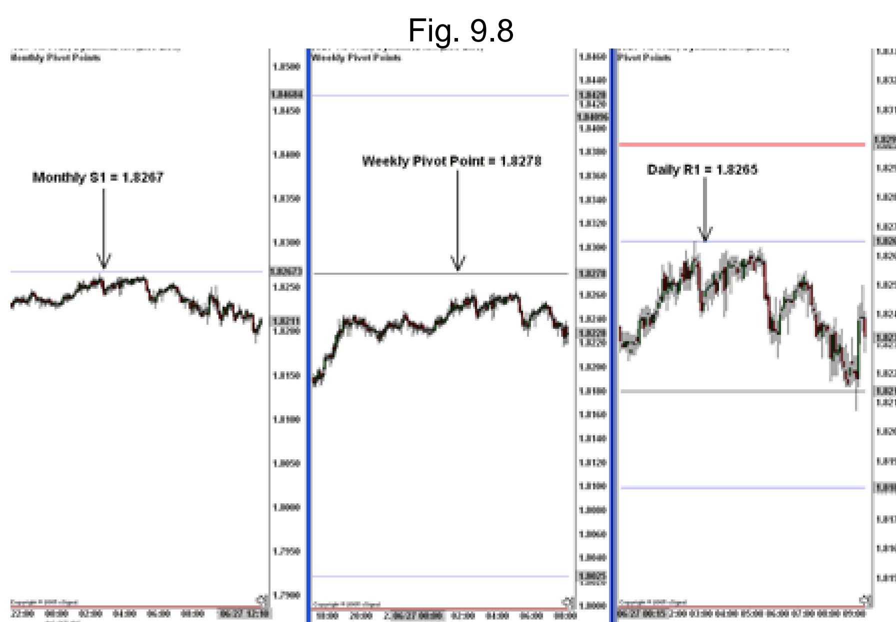
You can trade against the trend but it will help you to know if you are trading with or against the trend.

Have a look at the chart below Fig. 9.8 On the left is a 5-minute chart with the monthly Pivot Points marked on it. In the middle is a 5-minute chart marked with weekly Pivot Points on it and on the right a 5-minute chart marked with the daily Pivot Points on it.

The monthly S1 was 1.8267, the weekly Pivot point was 1.8278 and the daily R1 was 1.8265. There is a confluence of Pivot levels from different time frames all around the same area. This makes this area a very strong resistance area.

The point is this, when you have a confluence of Pivot levels all around the same area there is usually an opportunity to trade.

Fig. 9.8



At this point I need to digress a little bit and explain a few basic candlestick patterns. For more information on candlestick patterns refer to two of your bonuses “Trading For Beginners” and “17 Money Making Candlestick Formations”.

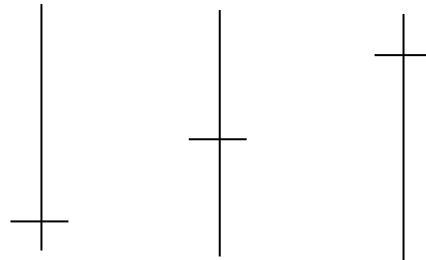
Most Important Candlesticks

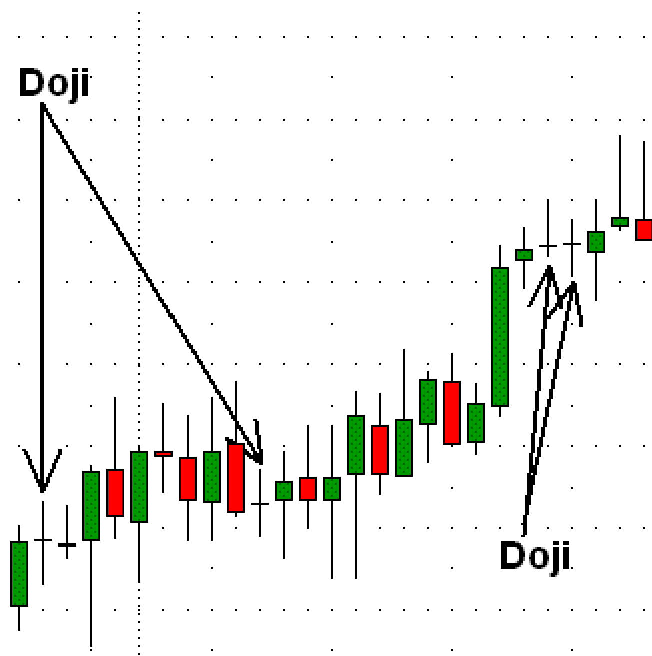
©

The first is the Doji – this is a candlestick with a very small body. In other words the close is the same as the open or very close to it. There is more than one type of Doji but for the purpose of this book, this description is good enough.

Fig 9.9

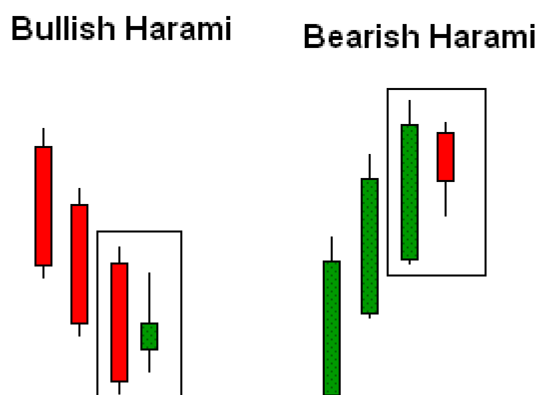
Doji





Harami – This is a two candlestick formation where the small real body is completely covered by the previous candlesticks much larger body.

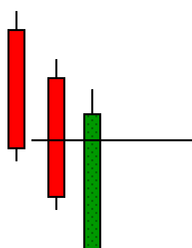
Fig. 9.10



Piercing Pattern – This is a two-day bullish candlestick formation where the open is lower than the close of the previous candlestick but closed about the midway point of the previous candlestick.

Fig. 9.11

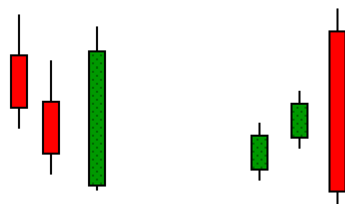
Piercing Pattern



Engulfing Pattern – This pattern is a two-day pattern where the candlestick totally engulfs the previous day's candlestick.

Fig. 9.12

Bullish Engulfing **Bearish Engulfing**



OK, back to our trading plan. Let's have a look at how we would use these patterns with Pivot Points. Also remember that you can use any of the patterns in the "17 Money Making Candlestick Formations". I am not an expert in candlesticks, in fact I still call them bars half the time; I just never got out the habit.

Fig. 9.13 is a 30-min USD/JPY chart demonstrating a Doji trade.

Fig. 9.13

Trading Rules:

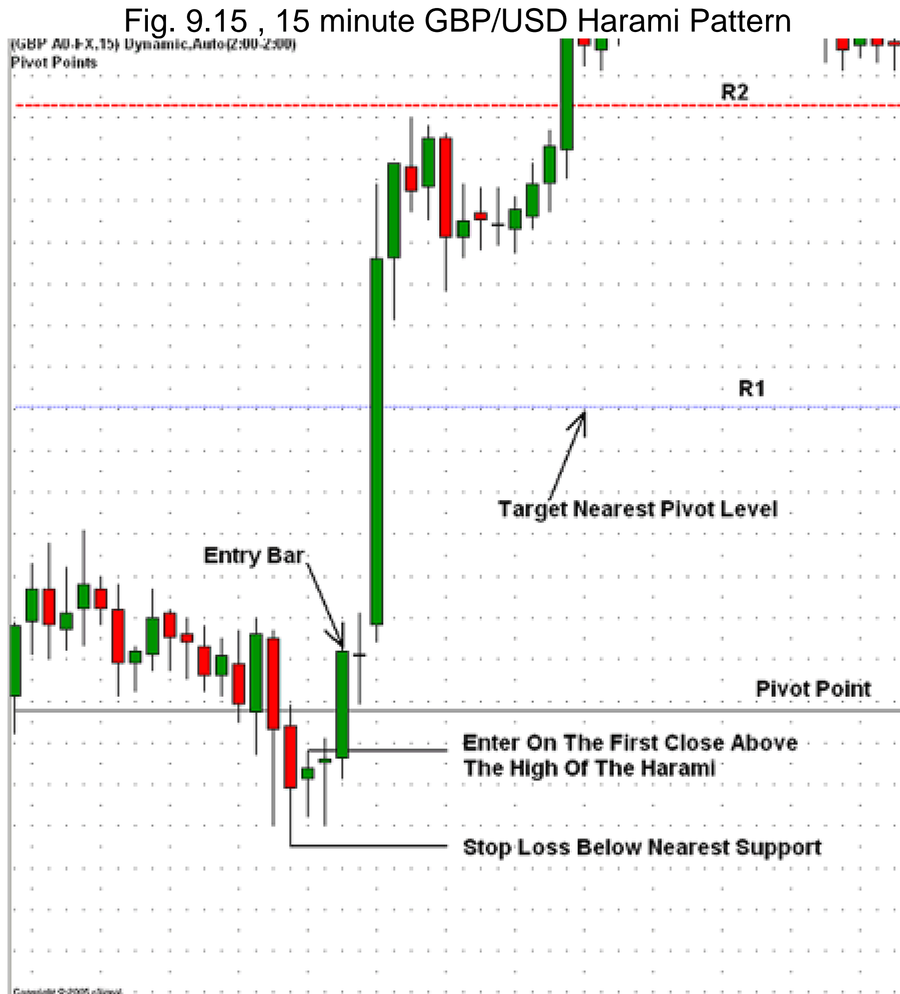
1. Be aware of where the trend is as determined by the monthly, weekly and daily Pivot Points.
2. Look for a bullish or bearish candlestick pattern at or near a Pivot Level.
3. Place your stop loss at the nearest resistance or support area of the candlestick formation.
4. Enter on the first close above or below the candlestick formation.
5. Target the nearest Pivot Level.
6. Risk no more than 2% of your capital at any one time.
7. Do your checklist.

Points	Checklist	Yes	No
1	Has there been any significant general news.		
2	Is there any significant economic news out today?		
3	Am I prepared to trade today - Have I done my homework.		
4	Am I emotionally OK to trade today?		
5	Is there a great setup.		
6	Do I know where I want to get out of the trade if I enter - Target?		
7	Do I know where to place my stop loss?		
8	If there is a setup, will the trade be within my risk parameters.		
9	Do I have sufficient time to place the trade without being rushed?		
10	Are there any big economic announcements in the next few days?		

Fig. 9.14 -15 minute AUD/USD – Doji trade

Fig. 9.14 is an example of a Doji trade. You can see that just after the Doji there was a close below the low of the Doji. This is your entry bar (candlestick). The stop loss goes above the highest point near the formation, which should also be resistance. Target the nearest Pivot level.

Fig. 9.15 , 15 minute GBP/USD Harami Pattern



In the example in Fig. 9.15 is a Bullish Harami pattern. The same rules apply. Place your stop below the nearest support just before the candlestick formation and target the nearest Pivot level. Wait for a close above the high of the formation and then decide if you are going to take the trade.

Fig. 9.16, 15-minute EUR/USD Piercing Pattern

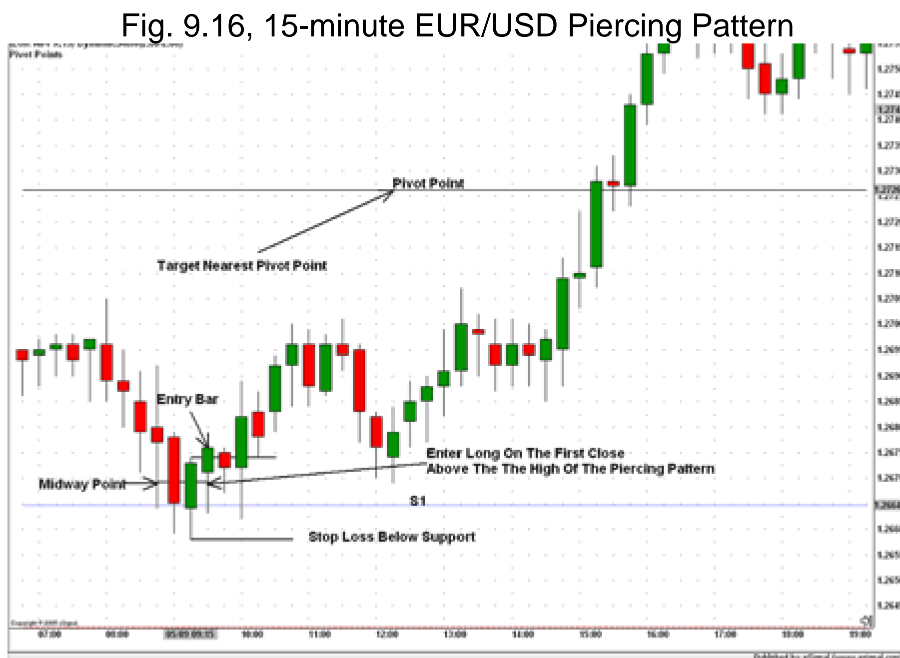


Fig. 9.16 , 15 minute AUD/USD Engulfing Pattern

Pivot Points by themselves are not a stand-alone method nor are candlestick formation; but together they can be very powerful.

There is one more thing we can add to our little Pivot Point and candlestick method that will make it very accurate and that is a couple of indicators.

The two indicators that I have found work well with this little method are stochastic and RSI.

Stochastic

George Lane was the originator of the stochastic indicator in the 1970's. Lane observed that as prices increase in an uptrend the closing price tends to be closer to the upper end of bars and in a downtrend closing prices tend to be nearer the lower end of bars. Lane developed stochastics to discern the relationship between the closing price and the high and low of a bar.

Typically used to identify overbought and oversold conditions the indicator consists of two lines: % K and %D. These two lines fluctuate in a vertical range between 0 and 100. Readings above 80 are considered overbought and readings below 20 are considered oversold.

Stochastic can also be use to generate buy and sell signals. When the faster %K line crosses above the slower %D line and the lines are below 20, a buy signal is generated. When the %K lines crosses below the %D line and the lines are above 80 a sell signal is generated. In our method we are more interested in stochastic divergence.

I use the following settings
% K =15
% K = 3
% D = 3

Relative Strength Index (RSI)

Relative Strength Index was developed by J.Welles Wilder Jr. and introduced in his book 'New Concepts In Technical Trading Systems'. It is one of the most popular technical tools around. Relative strength Index (RSI) is measured on a scale from 0-100 with a reading above 70 being overbought and a reading below 30 being oversold. Originally he recommended a 14-day period as the setting but many other time periods have now become popular. Wilder discusses 5 uses of RSI in his book.

Tops and Bottoms
These are indicated when the readings go above 70 (top) and below 30 (bottom)

Chart Formations
The RSI may form chart formations that may or may not appear on the actual bar chart e.g. you might see a head and shoulders formation on the RSI but not on the bar chart.

Failure Swings
When the RSI goes above 70 or below 30 this is a strong indication that the market is ready for a reversal.

Support and Resistance
It is sometimes more apparent that support or resistance is forming in the RSI than can be seen on the chart.

Divergence
When price makes a new high or low and this is not confirmed by the RSI this can be a very strong indication that a reversal is imminent. This is how I use RSI in this method.

I set the RSI to 14

In Fig. 9.17 below of the 15-minute EUR/USD chart you can see that the stochastic had dipped below the 20 line and then as the market moved lower the stochastic start to move up causing divergence.

Side note: Bullish divergence is when the market is moving lower but the indicator is moving up. Bearish divergence is when the market is moving up but the indicator is moving down.

The RSI also dipped below the 30 level and turned up as the market moved down causing bullish divergence on the RSI.

These facts, along with the fact that we were approaching a Pivot Level made for a high probability trade.

Fig. 9.17

In Fig. 9.18 below of a 15-minute EUR/USD chart, you can see that there is no divergence this time but there is still a great trade setup. The stochastic had reached the 80 level and started to turn down and the RSI had reached the 70 level and started to turn down. Also as the trade got triggered very close to R1 the logical target would be the Pivot Level.

Fig. 9.18

In Fig. 9.19 below of the 15-minute GBP/USD chart, you can see that there are actually two Doji's. In cases like this, the last Doji to be formed takes precedence.

Also, in this case, there was divergence in the stochastic but not the RSI. This is quite common. Obviously divergence in both stochastic and RSI is stronger than just one indicator. The RSI was however over 70.

Fig. 9.19

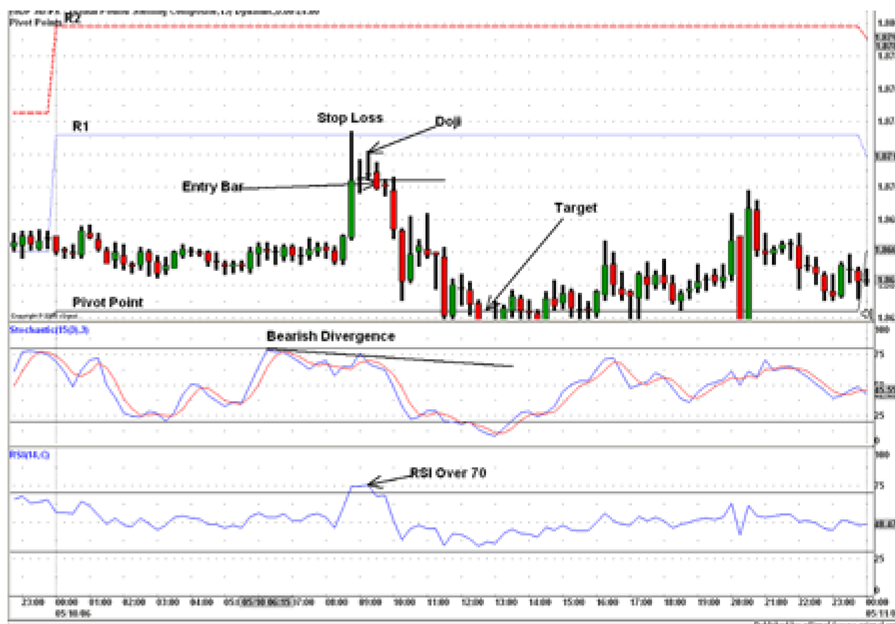
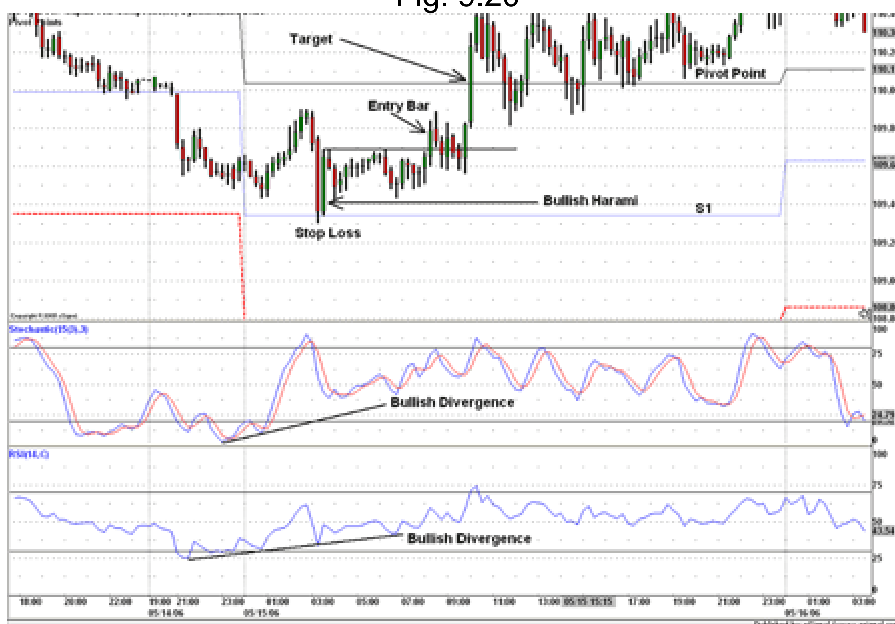


Fig. 9.20 below is a 15-minute USD/JPY chart. After the initial setup the trade did go on for some time before the entry was triggered with a close above the Harami pattern. Normally I wouldn't stay in this long but as no trade is triggered until there is a close above or blow a candlestick formation you can always decide when it happens if you want the trade.

Fig. 9.20



In Fig. 9.21 of the 15-minute USD/CHF chart, there is no divergence but the stochastic is over the 80 level and signaling down and the RSI is over 70 and also turning down and last but not least the market is at the R2 level, which in itself indicates that it is overbought and makes for a reasonable trade.

Fig. 9.21

In Fig 9.22 below of the 15-minute USD/CHF chart, the stochastic reached the 20 level and started turning up at the same time the RSI dipped below the 30 level and started turning up. The Doji formed just below the Pivot level. Taking all of the above into consideration you have a decent trade.

Fig. 9.22

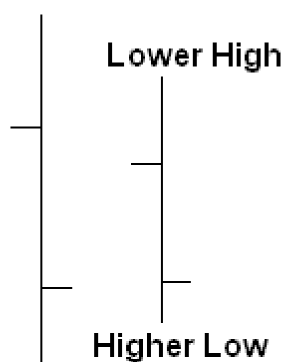
This method is a very nice method of trading using just about any time period. Like everything else do some paper trading with it first until you get comfortable. Also start keeping a journal of the most successful candlestick patterns. Over time and with some practice this will develop into a very nice little trading plan for you.

Trading Plan # 2

Inside Day Reversals

This is a very powerful set up and can be highly accurate if you trade it right. It's a play on the basic inside day pattern so first I need to explain what an inside day is.

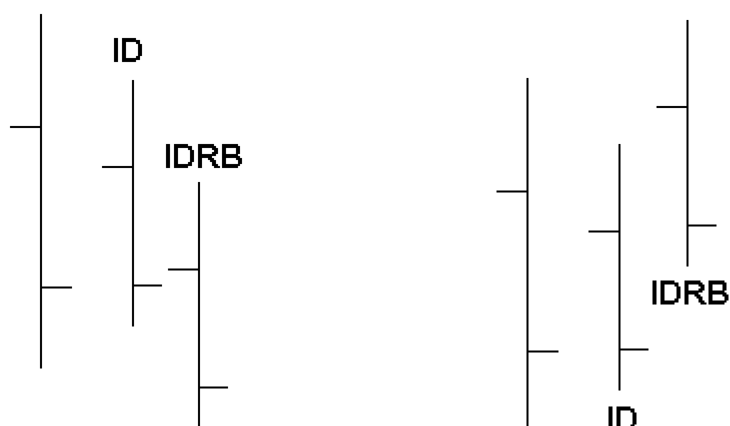
Fig. 10



An inside day is simply a bar that has a lower high and higher low than the previous day - nice and simple. Now here is where it gets interesting. We are going to take this concept and add to it.

Inside Day Reversal Pattern

Fig. 10.1

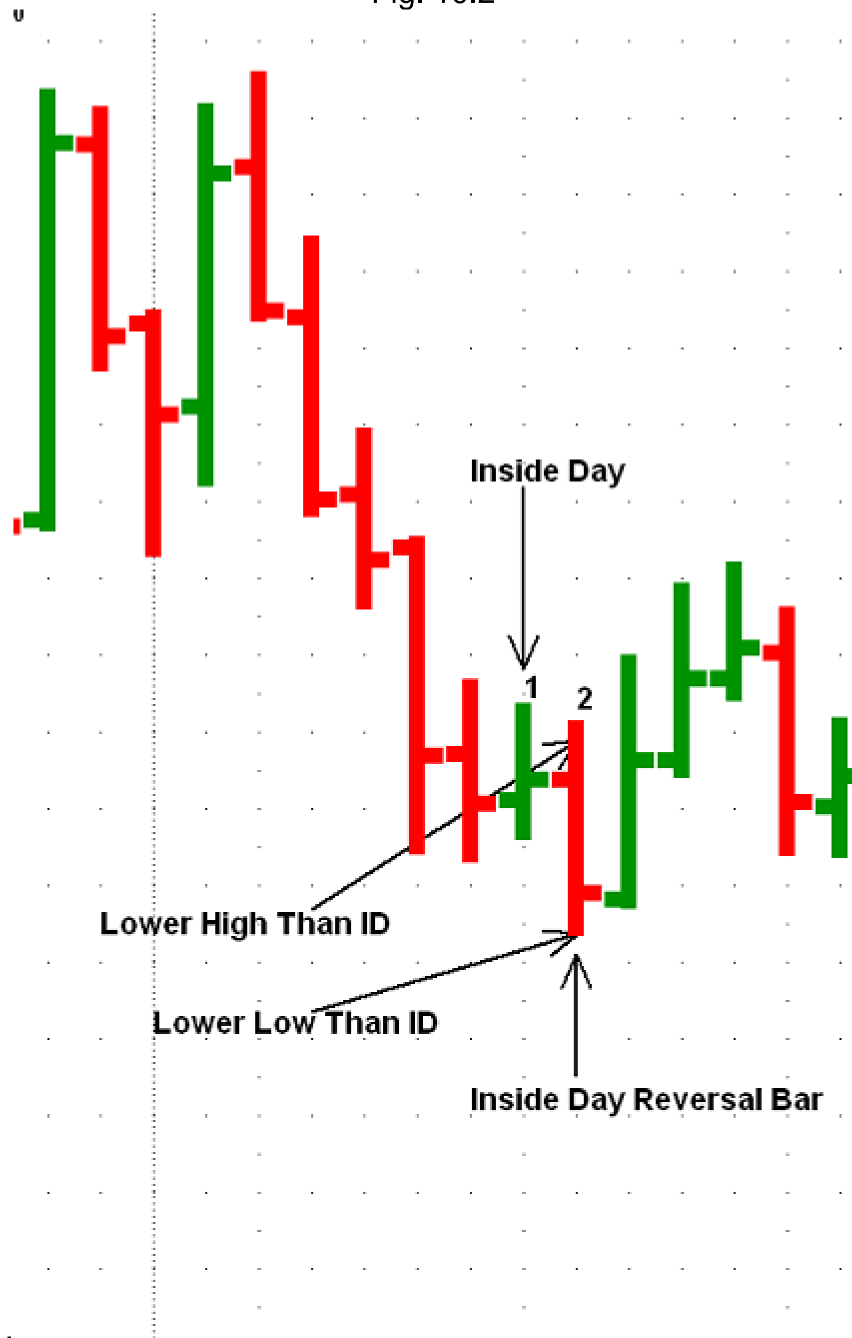


Have a look at Fig. 10.1. The inside day is marked ID and the inside day reversal bar is marked IDRB. In order for there to be an IDRB there must first be:

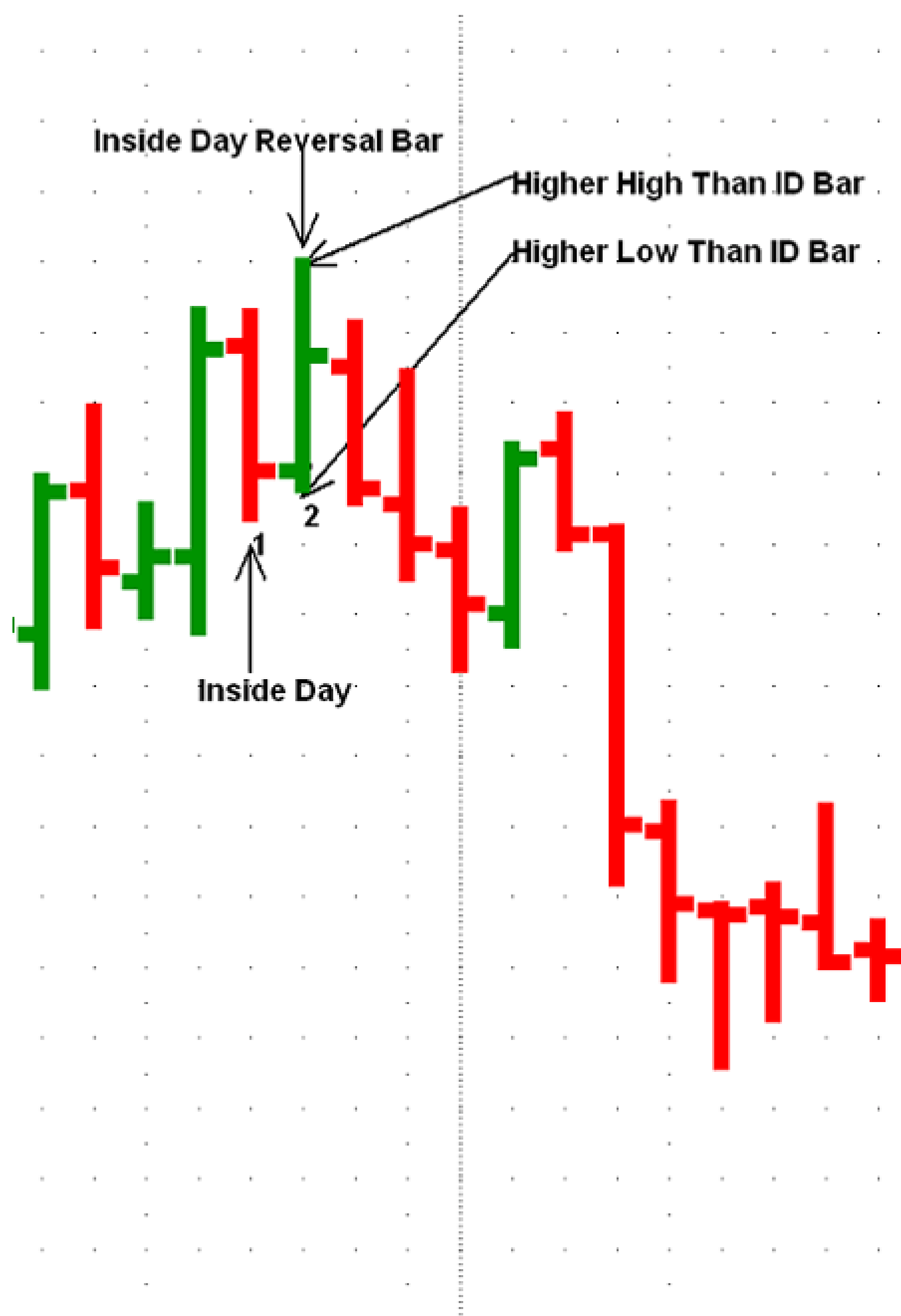
1. An inside day (ID)
2. The IDRB must have a lower high and a lower low than the ID bar for a bullish setup.
3. The IDRB must have a higher low and a higher high than the ID bar for a bearish setup.

Below, in Fig.10.2, you will see an example of a bullish IDRB. The bar marked "1" is the inside day with a lower high and higher low than the previous day. The bar marked "2" is the IDRB with a lower high and lower low than the ID bar.

Fig. 10.2



In Fig. 10.3 you can see an example of a bearish IDRB. The bar marked “1” is the inside day with a lower high and higher low than the previous bar. The bar marked “2” is the IDRB with a higher high and higher low than the inside day.



Now, when I talk about "bar" they could be any bars e.g. they could be monthly bars, weekly bars, daily bars or any time period.

The trick is to identify the IDRB on a higher time frame and trade it on a lower time frame. You might identify the IDRB on a monthly chart and trade the weekly or daily charts, you could identify the IDRB on the weekly charts and trade the daily charts or identify the IDRB on the daily charts and trade an intraday time frame.

At this stage I want to introduce you to Bollinger Bands

Bollinger Bands

Bollinger bands are an integral part of just about every charting system I have ever seen but many traders are unfamiliar with how to use them.

History

Bollinger Bands were invented by John Bollinger as a means of determining what could be considered as high or low around a give price.

The bands are plotted at a standard deviation (statistical term for measuring volatility) around a moving average. Typically the standard deviation used is 2.

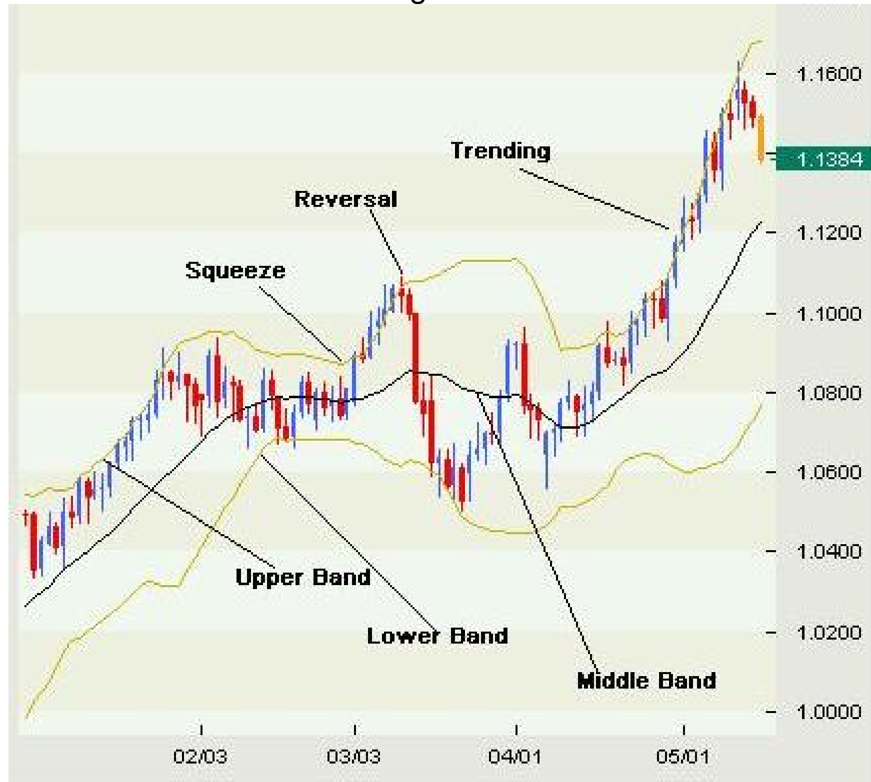
The bands appear on charts as 3 bands.
1. A simple moving average in the middle. Most charting software defaults to a 20 period moving average.
2. An upper band calculated around a simple moving average plus 2 standard deviations.
3. A lower band calculated around a simple moving average minus 2 standard deviations.

For our examples we will use the most common setting of a 20 period simple moving average. This will give us 3 bands, the middle band of a 20 period simple moving average and the upper and lower bands calculated around the middle band with standard deviation of 2. The closing price is most commonly used to calculate the moving average.

Bollinger bands can be used to generate buy and sell signals but that is not their primary use. The main purpose of the bands is to:
a) To identify areas of high and low volatility
b) To identify periods when price is at an extreme and possibly ready for a reversal.
c) To identify a trending market.

See Fig. 10.3 below:

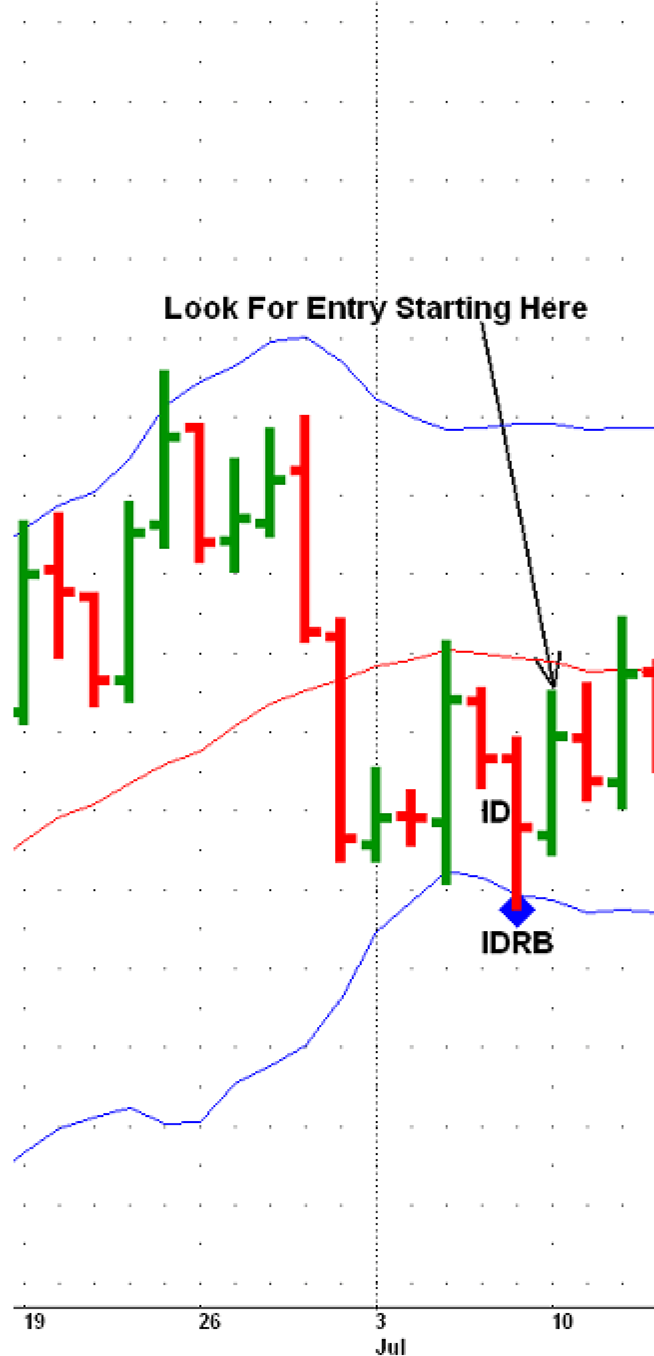
Fig. 10.3



On the higher time frame I use Bollinger Bands just to give me some kind of direction. On the lower time frame I use Bollinger Bands for my entry and exits.

In Fig. 10.4 below of the daily USD/CHF the ID bar was the 6th July, the IDRB was on the 7th of July so we would be looking for a long trade the next trading day, which was the 10th of July as the 7th of July was a Friday.

Fig. 10.4 – Daily Chart



The next chart Fig. 10.5 is a 1-hour USD/CHF chart over the same time period. The first vertical blue line to the left is the start of the 7th of July. The second vertical blue line is the start of the 10th of July.

As we had a bullish IDRB on the daily chart, we are looking for a long trade on the 1-hour chart. When we get a close above the upper Bollinger Band that is the signal to go long.

Fig.10.5

Depending on market conditions the initial stop loss can be below the most recent low or the middle (centerline) depending on what looks to be the safest place for the stop.

If you are trying to build a position or are looking to stay in the trade for a few days you can use the centerline or the lower band as your stop loss. If you get a good move you might want to exit on the first close below the upper Bollinger Band for long trades.

Trading Rules:

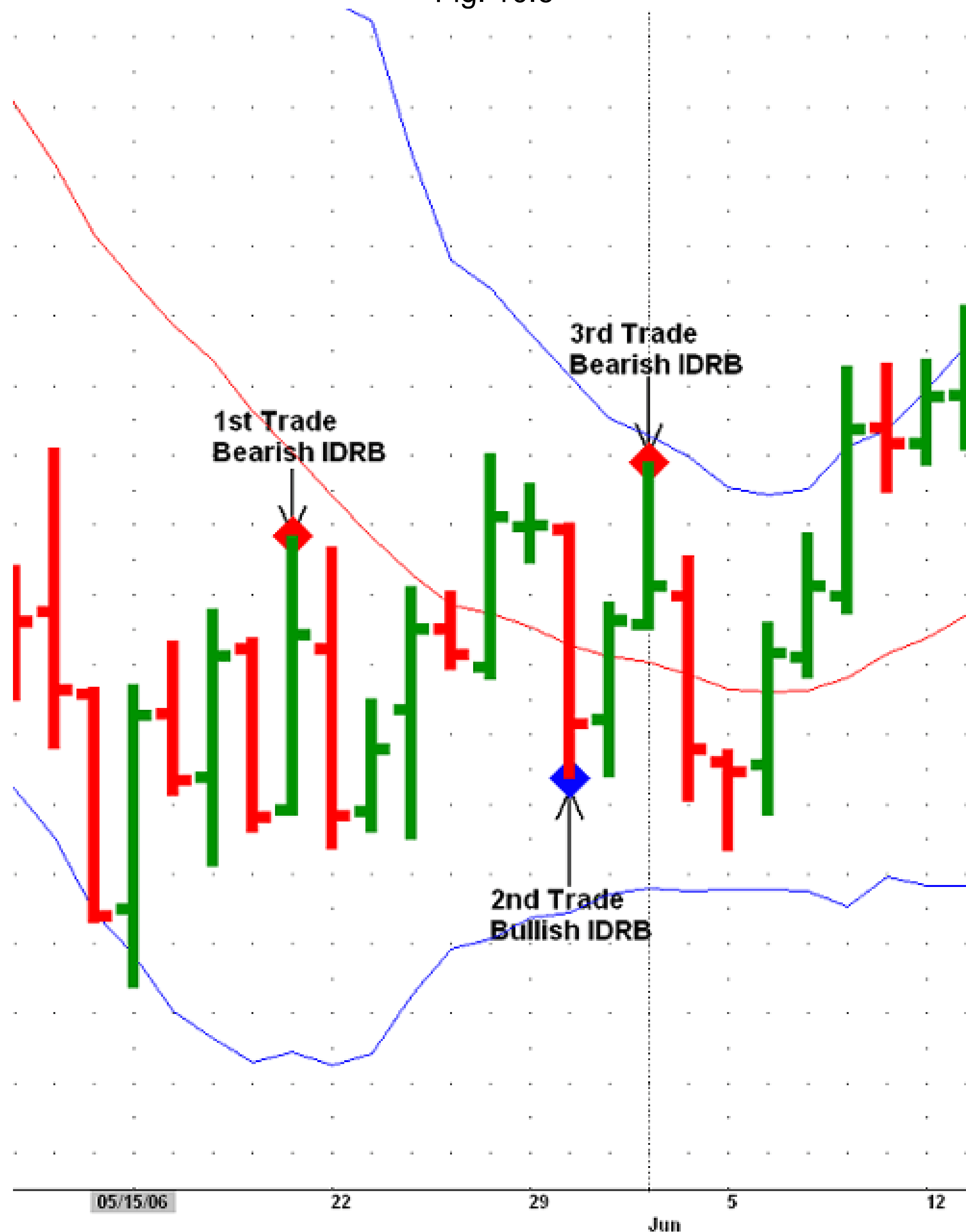
1. First identify an IDRB on a higher time frame
2. Drop down to a lower time frame for entry, exit and to place your stop loss.
3. For long trades there must be a bullish IDRB on a higher time frame and for short trades there must be bearish IDRB on a higher time frame.
4. On the shorter time frame enter long on the first close above the upper Bollinger band and for short trades enter on the first close below the lower Bollinger band.
5. Place your stop loss below the nearest support level after entry for long trades and the nearest resistance level after entry for short trades. The middle band can be used for the initial stop loss if it makes more sense.
6. If the move is thrusting and you are already in profit close the positions on the first close inside the Bollinger bands. If the market is drifting then the middle band can be used as the stop level.
7. Risk no more than 2% of your capital at any one time.
8. Do your checklist.

Points	Checklist	Yes	No
1	Has there been any significant general news.		
2	Is there any significant economic news out today?		
3	Am I prepared to trade today - Have I done my homework.		
4	Am I emotionally OK to trade today?		
5	Is there a great setup.		
6	Do I know where I want to get out of the trade if I enter - Target?		
7	Do I know where to place my stop loss?		
8	If there is a setup, will the trade be within my risk parameters.		
9	Do I have sufficient time to place the trade without being rushed?		
10	Are there any big economic announcements in the next few days?		

In Fig. 10.6 of a daily chart of the USD/CHF below, you can see that there are three IDRBs in short succession. This is not unusual.

The first bearish IDRB was Friday the 19th of May so we would be looking for a trade on Monday the 22nd of May. The second bullish IDRB was May 30th so we would be looking for a trade on May 31st. The third bearish IDRB was June 1st so we would be looking for a trade on the June 2nd.

Fig. 10.6



Let's go through each trade.

The 1st Trade is on the 1-hour USD/CHF chart of Fig. 10.7 below. Remember for bearish IDRBs we are only interested in short positions. You enter on the first close below the lower Bollinger Band. The initial stop loss is above the most recent resistance or the middle line. You exit on a close inside the lower band or if you are trailing your stop when price hits the middle line.

It also depends on market conditions. Sometimes you will have lots of little closes inside the band and it makes more sense to use the middle line as your exit.

Fig. 10.7

In Fig. 10.8 of our 2nd trade below you can see a 1-hour USD/CHF chart. We are looking to get long as we had a bullish setup on the daily charts. Here you can see that it made more sense to use the middle (center line) as the initial stop as it was far enough away to avoid whipsaw. This is also a good example of what I said earlier about having to use your discretion about how to exit. Sometimes it makes sense to exit on the first close below the upper band and other times it makes sense to use the middle line as your exit.

Fig. 10.8

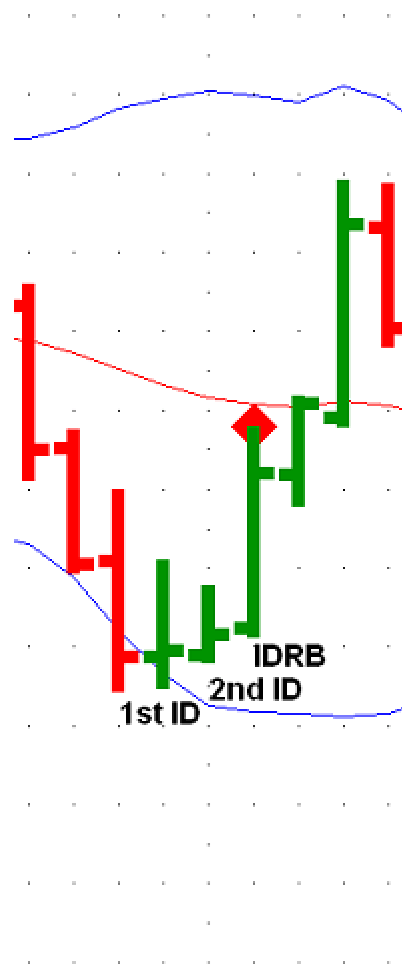
The 3rd trade, in Fig. 10.9 of a 1-hour USD/CHF chart, we are looking to go short as the daily IDRB was bearish. The same rules apply to this trade but take careful note of the bar I have marked "Expansion Bar." An expansion bar is simply a bar that is unusually big relative to all the bars around it. This indicates thrust (momentum) in the market. If you are already in a trade it is often a great time to exit. If you haven't entered the trade, be aware that often an expansion bar is followed by a retracement.

Fig. 10.9

In Fig. 10.10 below of the daily USD/CHF, you can see a bearish IDRB. The first ID bar was the 17th of March, the second ID bar was the 20th of March and the third ID bar was March 21st. I wanted to mention this for two reasons

1. When you have one ID followed by another ID it often breaks the wrong way.
2. In the next 1-hour USD/CHF chart, I wanted to show you what happens when the market goes the opposite direction from what you expect.

Fig. 10.10



In Fig. 10.11 below, you can see what happened on the March 22nd set up. As we had a bearish signal on the daily charts we wanted to go short but the market never closed below the lower band so no action was taken.

Fig. 10.11

Ok, you should have the idea by now. I will do one more example before moving on.

Fig. 10.12 of the daily EUR/USD chart shows a bearish setup. The IDRB was Friday, July 7th. We are looking for a short trade on Monday, the 10th of July.

©

Fig. 10.12 Daily EUR/USD

Fig. 10.13 below is the 1-hour EUR/USD chart and what happened that day.

Fig. 10.13

Just one final thought on this method. Once you have identified an IDRB, you can use just about any technique on the lower time frame to get into and out of the market. This plan is a very powerful plan and one I am sure you will have fun with.

Trading Plan # 3

Rainbow Trading

This particular strategy is a lot more discretionary; it is also not for the faint hearted. Think of the other two plans as a scalpel and this plan as a broad sword.

In this plan you are looking for big fat moves to take truckloads of profit. When you get this plan right you win big. The secret here is money management. There's that word again☺

You have to make sure you keep your loses small and you have to ride the move as far as you can with this plan. You might find that you are in a move anything from 1 day to a few weeks.

If you don't like to watch the screen you will love this. Once you are in you can leave the position alone for big chunks of time.

This method is called the rainbow method because it has lots of moving averages and when they fan out it looks like a rainbow. The colors are unimportant; just use whatever colors turn you on.

Here goes!

To start with you will need eight exponential moving averages:

- 8 Period Exponential Moving Average
- 13 Period Exponential Moving Average
- 21 Period Exponential Moving Average
- 34 Period Exponential Moving Average
- 55 Period Exponential Moving Average
- 89 Period Exponential Moving Average
- 144 Period Exponential Moving Average

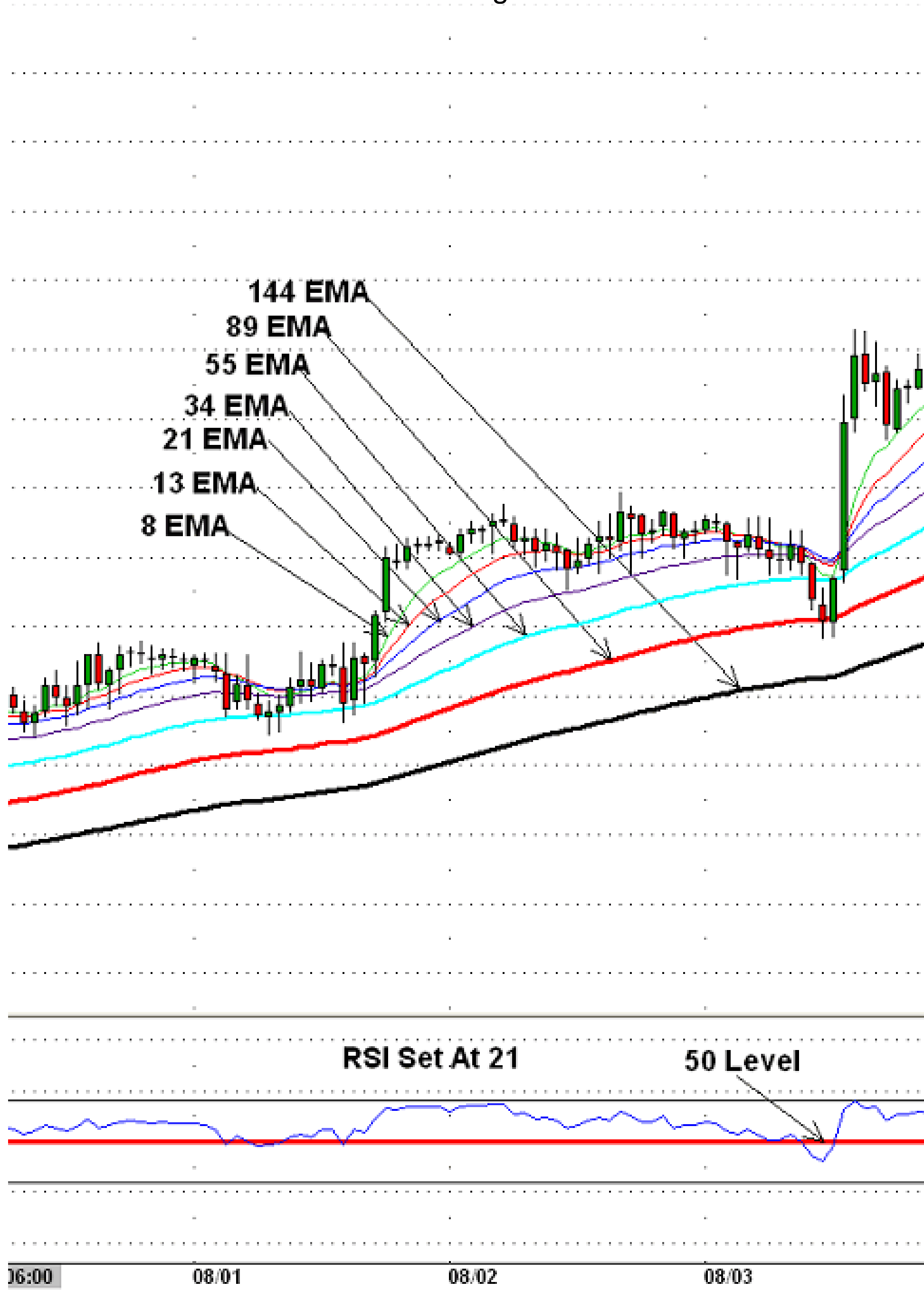
Readers who have a copy of my www.surefire-forex-trading.com course should be familiar with some of these averages.

On a chart it would look like this (Fig. 11) on a 1-hour GBP/USD chart.

Fig. 11

Next we are going to add the RSI indictor set at 21 with the 50 level marked in red, Fig. 11.1

Fig. 11.1



Next, we are going to add the Bollinger Bands but with the middle line (centerline removed), I don't want to confuse the middle line with the other moving averages – Fig 11.2

Fig. 11.2

The four most important averages are the 8 and 13, and the 89 and 144.

Think of the 89s and 144s as a highway. If the 89 exponential moving average is above the 144 exponential moving average then the trend is up and you only take long trades.

If the 89 exponential moving average is below the 144 exponential moving average then the trend is down and you only take short trades.

Some readers may recognize all the averages as part of the Fibonacci number sequence. This is no accident but this course is not about Fibonacci so I am not going to go into the subject. It is also not necessary for you to know anything about Fibonacci for this method.

The Squeeze Trade

In the Fig. 11.3 of the 1-hour GBP/USD we have a "squeeze trade." First the red 89 EMA was below the 144 EMA so we know that we should be short. The 8 EMA squeezed very close to the 13 EMA but did not cross. The RSI was below 50.

As the 8 and 13 EMAs squeezed together we are looking to go short either when it takes out the support or we get a solid down bar. When I say solid down bar, I mean that the bar (candlestick) should be a reasonable sized with a reasonable body. Not a tiny little down bar that is barely more than a Doji.

As the trade progresses the 55 EMA, 89 EMA and 144 EMA act as a trailing stop loss. If you had three contracts you could exit the first contract when the 55 EMA gets hit, the second contract when the 89 EMA gets hit and the last contract when the 144 EMA get hits.

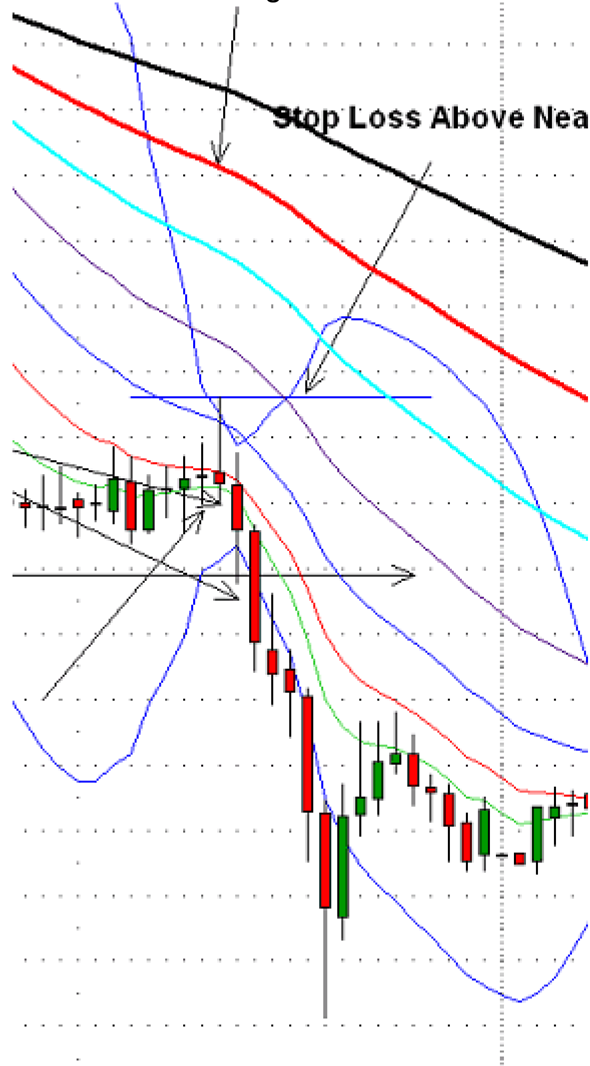
Fig. 11.3

The other averages e.g. the 21 and 34 EMAs can also act as a trailing stop loss. It depends on market conditions. If the market takes off like a rocket then you might want to exit when either the 21 or 34 EMA gets hit.

Fig.11.14 below is a close up of the setup

©

Fig. 11.4



Trading Rules:

1. For short trades the 89 EMA should be below the 144 EMA
2. For long trades the 89 EMA should be above the 144 EMA
3. The RSI should be above the 50 level for long trades and below the 50 level for short trades when you enter the trade. The RSI should stay above the 50 level during the trade for long positions and below the 50 level during the trade for short positions.
4. A setup is identified when the 8 EMA comes very close to the 13 EMA forming a squeezing action.
5. The entry bar is the first solid bar in the direction of the trade e.g. a down bar for short trades or an up bar for long trades. You can also use the nearest support once breached as an entry for short trades or when the nearest resistance is breached for long trades.
6. The stop loss is set initially above the nearest resistance for short trades or the nearest support for long trades. Any one of the EMAs can also be used as the initial stop if it makes sense.
7. Exit when your trailing stop loss is hit. Your trailing stop can be any one of the averages depending on market conditions. Generally the 55 EMA is a dependable trailing stop loss.
8. Risk no more than 2% of your capital at any one time.
9. Do your checklist.

Points	Checklist	Yes	No
1	Has there been any significant general news.		
2	Is there any significant economic news out today?		
3	Am I prepared to trade today - Have I done my homework.		
4	Am I emotionally OK to trade today?		
5	Is there a great setup.		
6	Do I know where I want to get out of the trade if I enter - Target?		
7	Do I know where to place my stop loss?		
8	If there is a setup, will the trade be within my risk parameters.		
9	Do I have sufficient time to place the trade without being rushed?		
10	Are there any big economic announcements in the next few days?		

In the next chart (Fig. 11.5) of the 1-hour EUR/USD you can see we had four squeeze trades. The 89 EMA was below the 144 EMA and the RSI was below the 50 level.

Fig. 11.5

Let me just mention what constitutes a good squeeze. The 8 and 13 EMAs should move very close to each other. How close they should be I have never measured. I just eyeball the fact that they are close. It is still ok if the 8 EMA crosses the 13 EMA for a bar or two but the cross should not be thrusting. In other words, if the 8 EMA does cross the 13 EMA then it should just be a slight move up. If you get a big long up bar that takes the 8 EMA past the 13 EMA that would obviously not count.

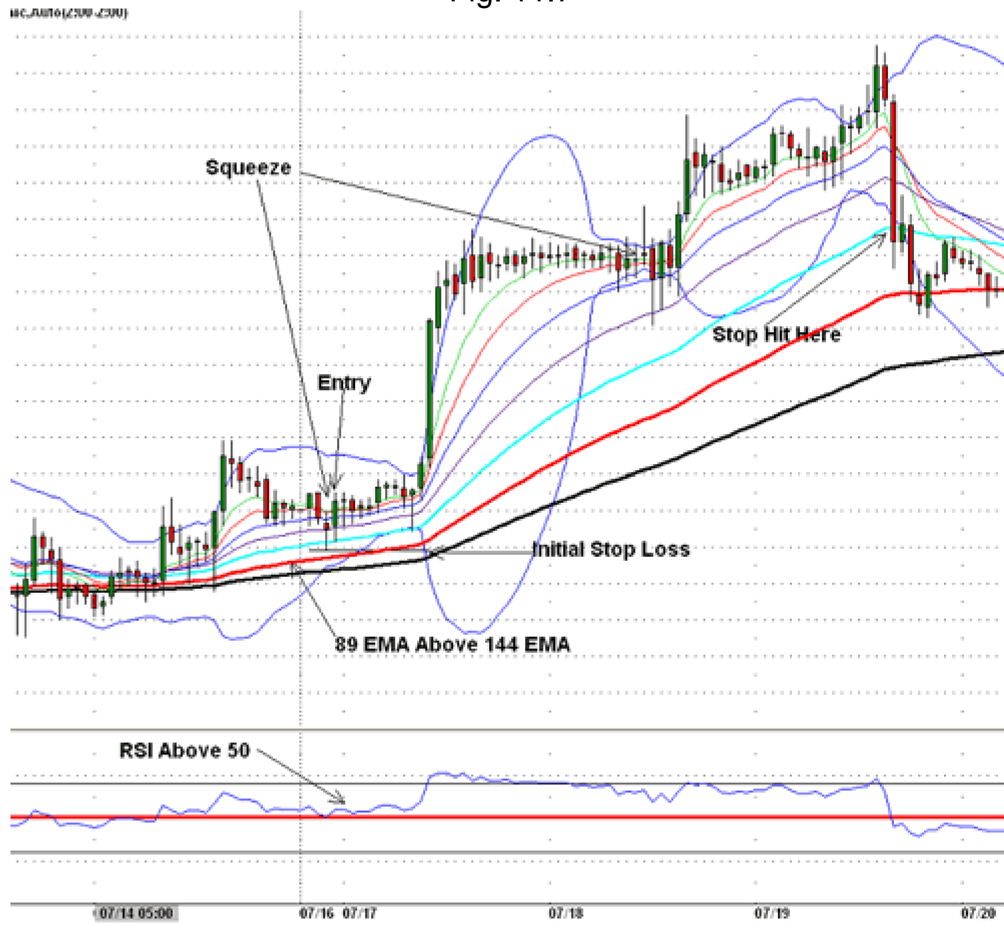
The next chart, Fig. 11.6 below, is the same chart but the move went on too long to show on one chart. The first squeeze entry was around 1.2703 and the

55 EMA was hit at 1.2527 (176 pips). That's the beauty of this technique. You want to shoot for big runs.

Fig. 11.6

In our next example Fig. 11.7 of the 1-hour USD/CHF, you can see that the 89 EMA was above the 144 EMA and the RSI was above 50. The 8 EMA squeezed close to the 13 EMA. You go long on the first sold up bar and ride it out until your stop gets hit when the market falls back to the 55 EMA.

Fig. 11.7



In the next chart, Fig. 11.8 below, of the 1-hour USD/JPY, is another example of a squeeze trade.

Fig. 11.8

The Double Squeeze

An even stronger signal is given when you spot a squeeze that has also just pierced the lower or upper Bollinger band but the whole setup remains above/below the 55 EMA, 89 EMA and the 144. See Fig. 11.9 of the 1-hour USD/CHF

Fig. 11.9

If you think back to our first example, see chart Fig. 11.10 below, it was actually a double squeeze.

Fig. 11.10

There are actually a lot of ways to trade this setup. You can try adding stochastic to help identify when to enter e.g. when you get a stochastic sell signal with a squeeze setup you could use that as a way to enter.

You could use a higher time frame to identify the squeeze and then drop down to a lower time frame and trade in that direction. The options are endless. All the squeeze trade is doing is identifying a consolidation period during a trend. Often, the biggest moves come out of consolidation.

Ok, my friend. I hope you enjoyed this journey that we had together. I want you to ask yourself this one questions:

Did you learn at least one thing?

If you did, then the course was worth every penny you paid for it. The whole point of the course is to give you ideas and concepts that you can use. I want you to finish reading this book excited about the possibility of trading full time. I want you to try my ideas. I want you to invent new ones and I want to hear back from you. Let me know how you are getting on.

Let's Summarize

1. You should apply some kind of money management to your trading. Now I know that it would be nice if everyone only used 2% of their capital every time they traded but I know a lot of traders won't. If you can't stick to that rule then just risk as small amount as you can.
2. Problems with the psychological aspect of trading often stem from not believing in your method or system. You need to work with an idea and take it to the point where you believe in it. Feeling nervous, anxious or just uneasy when you first start trading is normal. Don't try to become a machine, just learn to acknowledge and respect your feelings. Listen to the MP3s that come with the course. They will help.
3. Decide what time frame you like to trade in. There is no one time frame that is better than the others. Choose a time frame that suits your lifestyle and that you feel comfortable trading.
4. Stick to a plan. Write down your trading plan on paper and follow it. If it is not written down then you don't have a plan and you will never know if the reason it didn't work was because the method was bad or your psychology played a part.
5. Discretionary trading is not a science, it is an art but it must be approached as a science in order to develop a good trading plan.
6. Take action. You have enough information in this book to build your own plan now.

I have covered money management, different styles of trading, psychology and given you examples of some great plans. You should be able to take this information and make your own trading plan now.

Questions & Answers

The important thing is not to stop questioning.
Albert Einstein (1879 - 1955)

Recently I did a survey of all my subscribers and asked them what their most important trading question was. There were loads of great question and I think it might help you to know what other traders think about. What follows are some of the over 1,000 questions I was asked and my answers.

Question:
How to make a mechanical trading system that rules out all human emotion.
Answer:
I am not a big fan of purely mechanical systems because of all the ones I have traded or looked at, they all have horrendous drawdowns and had very unspectacular results.

I define a mechanical system as a technique that has set rules that are totally objective as opposed to a discretionary approach, which is subjective. A mechanical system should be able to be traded by ten different traders and all of them should get the same results.

The problem is that if you gave a mechanical system to ten different traders they would all get different results because it is hard to rule out emotion, even with a mechanical system. The first time the mechanical system has eight losses in a row; most traders bail or question the system

Question:
I'm new to trading so I would like to know what are the most essential things that I should know to start trading.
Answer:
Don't be in a rush. You wouldn't expect to become a doctor in three months so don't expect to start trading and become an expert overnight. Take the time to learn this profession. Invest in your own education. When you start, allocate a portion of your trading capital to educating yourself.

Question:
Do indicators really work? There are hundreds of thousands of people trying to trade the markets using conventional technical analysis using the usual suspects of RSI, MACD, OB/OS etc, but less than 5% make any money. The evidence clearly refutes the use of these time-based indicators as profit generators. They provide signals too late and certainly cannot be used to predict any kind of move because they are derived from price and therefore follow it. The key question then is: how can one determine what the professional market manipulators are going to do before they do it? Forex markets can move 100 points in just 15 minutes and the professionals are out to set the small investor up for a hiding every day. This is where their profits come from.
Answer:
Great question and I couldn't agree with you more. Indicators by themselves just don't work but combining indicators or using them in a different way can.

For the other part of your question, there is a reason the FX markets and other markets experience fast sudden jumps. A lot of these moves are the result of economic announcements e.g. non-farm payroll can move the FX market hundreds of pips in a few minutes. I cover news and fundamental approaches in the course.

Question:
If having a method is important (I have the Surefire Trading Method), why have so many lessons on so many different ways of trading? Some videos relating to the methods you sell would help me get things much clearer.
Answer:
Good question. First, I am like everyone else. I am always looking for the next best thing. Because I buy so many courses myself, I come up with ideas. My subscribers are constantly in contact with me swapping ideas and plans. If I see something I think will work better than the last thing, then I trade it. That is not to say that I walk away from my other methods. If you live and break something every day you get to know it. I might be trading the IDRB and suddenly spot a Surefire Forex Trading signal or a Trader Code signal. As a trader I am a conglomeration of everything I have ever learned.

The reason I decided to do this course in book form was because of the support issues. The last course I did in video format gave me a headache trying to sort out why one browser didn't display in a particular way or why a particular operating system was having problems. I am not that

technical. My newsletter still contains many videos. I might have another crack at it in the future.

Question:
Can you show me an easy to follow and simple trading system that consistently makes a profit?
Answer:
This depends a lot on you. I can teach you how to paint but I can’t teach you how to be a Rembrandt. In other words, I have shown people how to trade and come back to check on them a few months later and they are doing something entirely different. On the other hand, I have shown a few people how to trade who have been trading successfully for years now.

Question:
What time frame do you trade?
Answer:
Knowing what time frame you should be trading that fits you psychologically is a very important part of trading. You have to feel comfortable trading that time frame. I have traded everything from tick charts to monthly charts. I now feel comfortable trading daily charts using a lower time frame for entries.

Question:
How to successfully scalp with technicals.
Answer:
I am actually against most traders scalping unless you are actually a Floor Trader. Most traders don’t know what real scalping is. Scalping in its true sense is a floor trader who will trade hundreds of times a day exploiting the bid/ask spread. Most traders see it as just taking tiny profits with a tiny risk. Even with Forex and 2 pip spread it is the hardest way to trade and one only an experienced trader should attempt. It involves watching tick and one minute charts and jumping in and out of the market really fast. All the “scalpers” I know burn out within six months because of the pressure and the focus that is required to watch a chart all day. As it happens I have a very good scalping method but I will need to save that for another time.

Question:
How to master one strategy that works?
Answer:
That is the million dollar question my friend. But the answer is in your question. Concentrate on one thing, one plan, and one system. Take the time to learn one strategy thoroughly. Don't jump around from one thing to the next. Try buying a few courses and see if they make sense to you or that you can adapt.

Question:
Do you trade Elliott Waves.
Answer:
I spent a very long time studying Elliott waves and Gann. I am very aware of the first five waves but the correct wave for me can very subjective. I still read up on it and buy courses on it but I am undecided about it right now. I have a love hate relationship with Elliott waves.

Question:
How do I spend less time at the screen and move to long-term trades?
Answer:
Make the market work for you. Find the time frame you would like to trade and make your trading plan around that. If you work full time and can only trade using daily charts by checking your position when you finish work then trade daily charts. I highly recommend that every trader start with a longer time frame anyway. Adapt your plan to your lifestyle. A good plan should be able to be traded on any time frame.

Question:
How do I development of effective trading plan?
Answer:
I hope to answer that question in my next course. But briefly, the plan should suit your lifestyle. The plan should incorporate a reasonably simple technique. The plan should have good money management principles.

Question:
How do I get started without a lot of money to invest?
Answer:
Nearly all traders I have ever come across are undercapitalized when they start. If you are short of money, don't trade. If you can't afford to lose what you are trading without it affecting your day to day living then it is not the right time for you to start trading.

Just keep studying and reading all the free stuff you can get your hands on. Use the Internet to find free stuff until your financial position changes.

Question:
I know there's different strokes for different folks, but in your opinion, what is the best type of trading, Day, Swing or Position, and why?
Answer:
It depends a lot on your personal circumstances. Are you in a financial position to dedicate all your time to trading? Are you comfortable trading that time frame? There is no best time frame that makes more money than another time frame. I know traders who trade weekly charts who make as much as scalpers and vice versa. It's a personal choice.

Question:
How to trust what you see from your indicators?
Answer:
Testing – by testing what you see over and over again you will get to know if the indicator is telling you the truth. If you see the same setup with an indicator e.g. divergence on stochastic at the bottom of a trend 100 times and X happens you will get to trust that setup.

Question:
How long does it take to become a successful trader? I've been trying for years, using many different strategies and I still struggle to even break even (but usually lose). Sometimes I feel that there's a greater force preventing me from succeeding!
Answer:
I hear you brother. Don't become disheartened. There is no set time to become a successful trader. For some it will happen quickly and for others it takes longer. I myself took many years to learn how to trade well. I also taught a young guy who picked up trading very quickly who within six month was trading all over the world just using his laptop.

If your trading isn't going well, take a break for a month. Really look at what the problem is. Is it you – are you not disciplined enough or are you letting your emotions get in the way or is it your trading plan. Sometimes walking away from the whole thing for a month can make all the difference. I have done it in the past.

There were over a thousand questions, most of them similar. If I ever do an update to this book I will make a point of including more questions and answers as I had some brilliant questions.

God Bless
Mark McRae

Resources

The following are some resources that you might want to consider to further your studies.

Forex

Obviously I am going to recommend a few of my own courses as some of the recommendations but I really do think they are good courses.

Surefire Forex Trading
Mark McRae
Basically it is two methods of trading the Forex market. They are different from the plans I have just covered. You can see it at
www.surefire-forex-trading.com

Bird Watching In Lion Country
Dirk du Toit
I really liked this book because he uses an unusual approach to the market in that he doesn't use indicators and also is passionate about money management. Very good read and will help anyone trading. You can see it
HERE

Any Market

Traders Secret Code
I poured my heart into this course. I recorded myself trading live using a method that I developed that at the time of this writing still hasn't had a loss. I let you watch as I place live trades in real time. Based around Fibonacci it is one of the best value for money trading packages anywhere. You can see it at
www.traderssecretcode.com

Instant Profits
By Bill and Greg Poulos
Bill put together a stunning course that I know he personally uses. This guy has been around for years and has probably forgotten more than most of us will ever learn. This is a monster course, I mean when I first got my copy I couldn't believe what was included. Very good method with a slant towards stocks. You can see it HERE

FibMaster
By Neal Hughs
Neal has always been one of my favorite traders. I have never met Neal but I have swapped emails with him many times. You know he actually lives on a boat and does all his trading from there. He really does live the traders dream. Probably one of the most genuine traders around. His methods are based on Fibonacci and when it comes to that subject I have never met a more knowledgeable person. You can see his website www.fibmaster.com

By Mark McRae
www.surefiretradingplans.com

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