Tips for Traders | 1/12/2009 9:56:00 AM

Five Tips to Help You Start 2009 with a Winning Edge!

The holidays are over and a new year is upon us. We're all rested, recharged, and eager to start trading. Some traders had a profitable trading year in 2008, while some traders had a rough ride. The NFA tells us that 90% of all people who open a retail brokerage account close their account after losing all the money in that account-and the average account is closed before twelve months has gone by! If 2008 gave you a rough trading ride, you may be wondering how to improve your trading this year, and even if you had a profitable trading year in 2008, there are always things to work on to improve your bottom line performance. I thought I'd start out this year with an article that highlights the most common problems I see when teaching traders how to be better traders, either in my group mentoring program or in my one-on-one mentoring program.

1. Always use stop loss orders! I don't actually see this problem in either of my mentoring groups, because I do extensive screening before accepting anyone for either program-and I refuse to work with anyone that does not use stops anytime they have a market position. But I am constantly amazed by the number of traders, experienced and inexperienced, that don't use physical stop orders (versus mental stop orders or no stop loss orders at all.)

   While managing professional traders at a large institutional trading desk in the 1980's and 1990's, I watched some of my best traders literally destroy their careers when they failed to use stop loss orders. They were relying on mental orders, and froze when their positions turned against them. And at the exchanges, a week doesn't go by that someone tells me about an acquaintance that went "tap" because they failed to use stop loss orders. And saddest of all, a young trader that signed up for one of my seminars last year E-mailed me a week before the online event to tell me that they would not be attending because they got caught long in a plunging E-Mini S&P market and lost all the money in their trading account-because they failed to use a stop loss order as protection.

   Stops are your friend! They protect you when things go wrong-and keep you in the game! The number one thing I feel every trader must do, this year and every year, is use stop loss orders for protection. I know many traders feel that as soon as they enter a stop loss order, the "players" will find their stop loss orders. And they'll be stopped out of their position just before price makes the large move they were looking for.

   With a little knowledge about the price structures that appear regularly in the market, it's easy to find logical areas to place your stop loss orders. These areas act as buffers that stop or slow price's advance or decline before it reaches your stop loss order-unless you have totally misread the market. And if you have misread the market, your stop *will* be hit, but that will be a good thing, saving you untold amounts of money. If you use stop loss orders intelligently, they can give you protection you must have and still give your positions enough room to mature.

   Please use stop loss orders every time you take a position. The markets are always right and none of us can afford to fight the market. If you get stopped out of your position, take a break and refocus. Once your thoughts are clear, look at the charts with a clear and open mind for new trade entry set ups.

Always plan your trade before placing your orders. Many traders like to trade "free form," with no plan. These traders feel they have freedom to react to whatever the market throws their way. But there are two very important reasons why trading with a plan is a better idea: 1) Trading can be hectic, and 2) Trading can be emotional.

If you have an open position and don't have a trading plan in place, when the market becomes overly volatile, you are left trying to make snap decisions. We have all recently experienced markets that were so volatile that it was difficult to tell where price was currently trading. Trying to make informed decisions and then execute them when the markets are volatile is a losing proposition. This often leads to excess slippage, or a failure to get filled on your orders because the market is moving so fast. And trying to type in orders while the market is moving extremely fast often results in errors. It is too hard to make money trading to give it away to execution errors.

When an open position begins to turn into a losing position, your feelings generally begin to cloud your judgment. Traders start to hope that they can hold onto their positions until the market turns back in their favor. If they have had a few losing trades in a row, some traders go as far as rubbing their favorite lucky amulet or praying to the trading Gods—and I am sure some would make a pact with the devil if they could get through to him! Let's face it: When your emotions begin to cloud your mind, you don't make the best decisions.

How can you best deal with hectic markets and the possibility of emotions clouding your judgment? Plan your trades before you take them. Write the trading plan out in detail. You'll have a step-by-step guide for each trade sitting in front of you. Then simply execute the plan, step by step. By having a plan, you have the security of having the road map right in front of you. If emotions start to creep in and make you nervous, you simply look at the step-by-step plan and execute as you planned it. One of my students calls it "trading by the numbers." This same plan will protect you if the markets suddenly get overly volatile. You'll have your stop loss orders in place when you first enter the position, and then it becomes an exercise of following the step-by-step decisions you made before you entered the trade, when the volatility was normal. You won't be forced to make snap judgments in a hectic market because you have the road map right in front of you.

A bad trade plan is better than no plan at all. With no plan, you are often forced to make snap judgments in volatile markets or when your focus is clouded by your emotions. I tell my students that their focus is at its best when they are first stalking a trade. As the stalking continues, and as the trade opens and unfolds, you spend more and more of your energy and ability to focus. Soon you are trading with half your original energy and focus, and that means you will be making decisions with half your original resources.

And don't underestimate the value of having well thought out records of your trade entry ideas. If you keep detailed trade plans and records, you will truly be able to treat your trading as the business it is. Furthermore, at the end of each month, you should go over the statistics of your trading. By analyzing your trading results on a month-by-month basis, you'll be able to see patterns emerge that will help you pinpoint your strengths and weaknesses as a trader. Once you learn to identify your strengths and weaknesses, you will be able to work on improving your performance in areas where you struggle as a trader. And you can play to your strengths by purposely choosing trading and money management styles that work well with your best attributes as a trader.

Every trader in my mentoring programs uses a trade sheet for every trade they take. At first, many find it cumbersome to write out their plan before entering a trade. But once they get into the habit, they begin to reap the benefits of having a detailed road map in front of them as a trade unfolds. And they also benefit from being able to analyze their trades on a monthly basis—which allows them to play to their strengths and work on improving their weaknesses. Begin using a trading plan before you enter your trades and you'll soon see how much help a road map can be.

More is often less! One of the most common problems I see in traders when they first start one of my mentoring programs is that they try to watch too many markets. Many times, these traders are struggling to get in the black on a regular basis, and yet, they'll be trying to learn a new trading methodology while watching fifteen or twenty markets. Unless you are a longer-term position trader, you don't have the ability to watch twenty markets in real time and give each market the attention it needs. It's hard enough to learn to juggle three balls with your feet firmly on the ground, but imagine trying to juggle twelve balls at a time while riding a bicycle!

I think that the majority of traders would be well served to find four to six markets that are liquid and have a nice daily range. Rather than overextend their focus, they can then closely monitor the handful of markets they have chosen for trade set ups they know they are capable of trading successfully. Once they have mastered the tools they use to trade, and have developed their eyes to spot repeatable trade entry set ups, four to six markets will present more than enough trading opportunities.

Most traders focus on their winning trades, but all of us must realize that when we lose money, we have to make that money back before we are net profitable. This sounds like something everyone knows, but believe me, many traders just don't think that way. If I had a dollar for every time a trader told me about their "big trade of the day," but admitted that they net lost money on the day when pressed, I wouldn't need to work another day. People remember what they want to remember—and that means they conveniently forget what they don't like to think about. By looking at too many markets, you may find more trades, but at the end of the day, or at the end of the month, you may be taking less money out of the market. The quality of your trades is much more important than the quantity of your trades.

Again, more is often less! I am constantly amazed at the barrage of inflated claims that the average trader has to wade through in their E-mail inbox and the trading magazines they read. For example, I recently received an E-mail inviting me to come listen to a "trading expert" who was going to show me how to catch "all the tops and bottoms." In the same week, I got another invitation to hear another expert explain how he turned $120 dollars into $126,000 in six weeks! And my favorite advertisement from one of the trading magazines features an expert that claims he averages 1,286% a quarter, and "You can, too!" Is it any wonder that the average trader uses too much leverage?

I have the same philosophy that a good friend of mine has when it comes to making money trading: The best way to make a good deal of money trading is to make smaller profits on a regular basis. All the small profits added together will build a huge pile of profits over time. Both he and I are considered large speculators in the markets we trade. I call this type of trading "making donuts" and he calls it "slicing sausage." I don't believe in trading for the home run. If one finds me, I'll take it, but the real money is made by consistently making profitable trades.

Every trader hears the stories of the guy on the exchange floor that made a killing because he pyramided his position over and over. As a young trader, one of my mentors was a gentleman that had "cornered" the copper market several times in his trading career. But one thing is certain about these traders that hold out for the home run profits every time they trade: They don't last very long. At the exchanges, you get to see guys that picked the top or bottom in a given market and rode it for a great ride. And you also get to see them lose all their trading capital the next year, because picking tops and bottoms is not a long-term winning proposition. And worse, using too much leverage always leads to ruin, whether it is by slowly bleeding your account to death or by one savage losing blow to your account.

Don't pay attention to claims that sound too good to be true. Trading is hard work. When you get very good at it, it is often repetitious. Once you find a methodology that works, you hone and master it, and then you use the same trade entry set ups over and over. The profits generated from these repetitive trades go on your profit pile. At the end of the month, you get to be pleasantly surprised when you add them all up.

But if you have one weak moment and put all your capital on one trade because you are convinced it is the "perfect" set up, chances are that all that hard work and all your capital will be gone. And you won't be able to trade any longer-the worst penalty that anyone who loves the markets could be sentenced to. Don't use too much leverage. Instead, rely on steady profits to build your accountÈ

Find the right tune to dance to when trading.

Now what the heck does that mean?

Do you ever feel like the markets are speeding by you, and you are struggling to find patterns and trade entries, but it's all just going by you too fast? Or, do you find yourself chewing on your fingernails or squeezing a rubber ball because it seems to take forever for that 20-minute bar to close? You might be doing the right dance to the wrong tune!

Traders are people, and each of us has a different ability to read the markets. Some of us are long distance runners, and some of us are sprinters; some of us are rabbits, and some of us are the turtles. If you are a fast-paced trader that craves action, you will not be comfortable trading off of a 60-minute bar chart. Similarly, if you like to ponder and think carefully about each trade, then trading a ten-tick bar chart of the e-mini S&P will make your head spin!

Markets have personalities in the same way that people have personalities. Some markets are hectic and have large trading ranges each day, while others seem to move rather slowly, unfolding their moves over time. To be successful as a trader, you have to find a rhythm for your own trading that isn't too fast or too slow—otherwise, you will be out of sync! And of course, each market you trade moves at a different speed, so if you trade three different markets, you may find you are watching a five-minute bar chart of one market, a 2000-tick bar chart of another market, and a 20-minute bar chart of a third.

The key is to get in tune with the market and find a time frame or charting frequency that works for that particular market and is also pleasing to you as a trader. Like the three bears, you don't want to trade in market conditions too fast or too slow. Instead, you want to find charting frequencies that are "just right" for both you and a given market.

These are five important ways you can improve your trading this year. None of them are flashy—instead, they are simple, common sense ways to approach trading that can make a great difference at the end of each month. Building your own trading methodology is like building a foundation for a house in that you use solid blocks that fit together well. Flashy materials don't last over time. Use time-tested methods that you have researched and that you know work. Once you have found a methodology that is profitable, don't give in to the urge to move on to something more complex or flashy. Always remember that the goal for every trader should be to make money consistently. If you have found a set of tools that you are able to make money with, spend time mastering those tools instead of exchanging them for the hot new indicator. Trading is hard work, but if you can master a trading methodology, it can be extremely satisfying—as well as profitable!

I wish you a wonderful and prosperous 2009!

Best,

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