GETTING THE EDGE

TRADING STRATEGY

CREATING OPPORTUNITY

CFDs AND FOREX TRADING

TRADING STRATEGY OVERVIEW

Becoming a successful trader doesn't happen overnight and it's important to set realistic goals. Of course making money is the key objective, but the best traders think of the long haul and show a measured approach. This document details a few fundamental lessons which we feel are extremely important to be able to survive and thrive as a trader.

TRADING STRATEGIES

The first thing traders need to understand is the instrument they are trading and the leverage involved. CFDs and forex carry a high degree of leverage, which can be an extremely powerful tool if utilised in the correct way. It is imperative that traders understand the risks, volatility (every instrument or asset class carries different degrees of volatility) and what the key factors are which can affect price action.

Having a strategy is obviously vitally important. Placing trades on gut instinct alone will rarely make money over the long term, although many will try. However, personality should play a major role in working out what works best for you. Whilst there are many different types of trading styles, there are a few classic ones which are commonly adopted by clients.

The fundamental-based trader bases their trades on valuation grounds or expectations around central bank policy. Systematic (or mechanical) traders use computer models to provide them with trade set-ups. A purely technical trader looks at chart patterns to understand supply and demand in the market and ultimately tries to predict future price action, while getting a sense of entry and exit points. Some will even use a blend of both fundamentals and technicals (which we will call 'technomentals'), whereby they will hold a fundamental view, but marry that with price action whilst looking at technical set-up's for entry and exit points. At the end of the day there is no right or wrong method and you have to be comfortable in what you do.

Traders can find a range of sources to educate themselves on a potential strategy; many will attend courses, read literature or visit financial websites to learn more. But one thing is for sure, mastering a strategy is an ongoing process and traders will generally make multiple alterations before settling on a strategy.

With these factors in mind our advice to new traders who are starting their journey is to start small, but think big. Until you understand and can harness the emotional aspect of trading, is the strict discipline and rules to which successful traders abide by will usually be thrown out the window on a sizeable drawdown (run of losses). Look at 'mini' contracts as a good starting point and upscale when comfortable.

FUNDAMENTAL–BASED TRADER

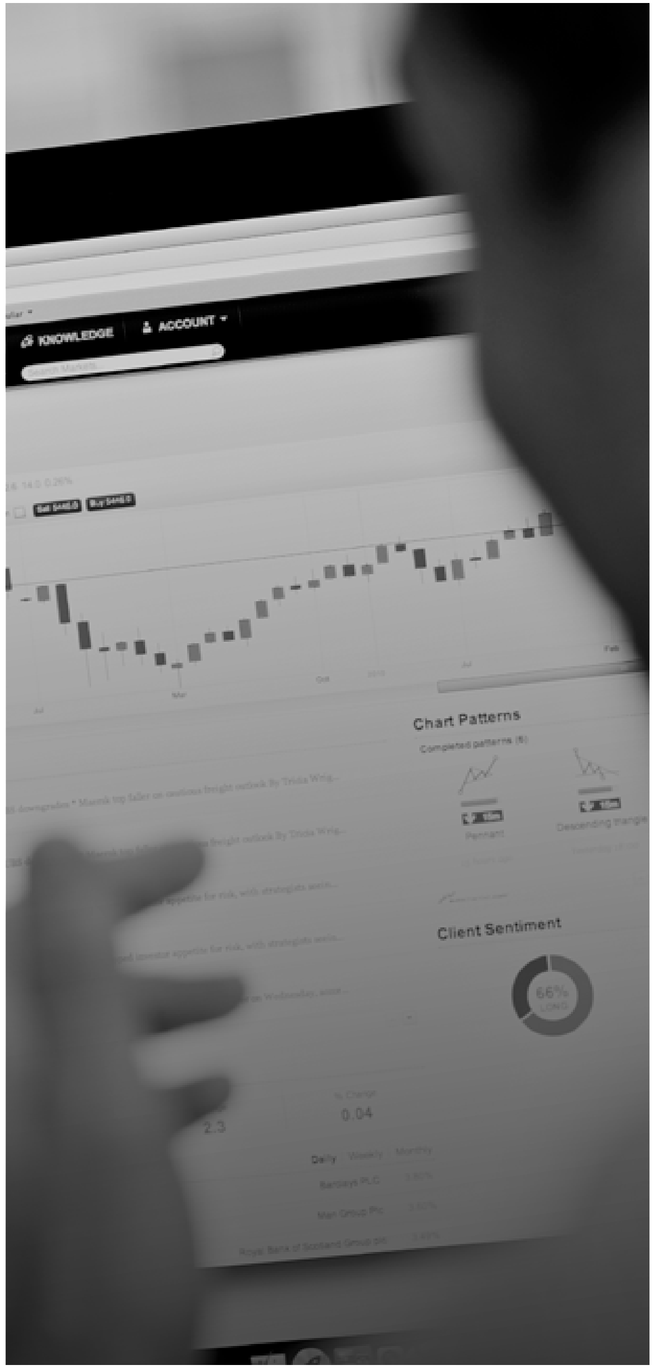
Bases their trades on valuation grounds or expectations around central bank policy.

SYSTEMATIC TRADERS

Use computer models to provide them with trade set-ups.

TECHNICAL TRADER

Looks at chart patterns to understand supply and demand in the market and ultimately tries to predict future price action, while getting a sense of entry and exit points.



RISK AND MONEY MANAGEMENT

Perhaps the key point, which we really can't stress enough, is to have a stringent risk and money management system. Successful traders will generally incorporate stops and limits into their trading strategy. However, it is not unusual for new traders to trade without stops and let their losses run as they refuse to believe their analysis can be incorrect. Human beings by nature believe that winning is paramount; that is especially true in trading. However, the best traders are also the best losers. Being able to accept that you are wrong, take the loss and move on to the next trade is fundamental in the trading world. Even the most successful traders will invariably make wrong calls.

The secret to successful trading is to think long term, but also think risk/reward. Even the best traders may only get 30-40% of his or her trades right, but the important aspect is making more on the winning trades than what would be lost on the losing trades. Many will work on a 3:1 risk to reward ratio; thus you can afford to be wrong often, but over the course of time using that equation should be profitable.

On the other hand, the emotional aspect of making a profit and feeling the need to close early – so as not to surrender the winnings – is extremely hard to overcome. You may have heard of FX and CFD clients losing money. Well simply put; many get the direction right, but fail on the risk management; thus claiming profits too early and letting the losses run. Over time this attitude blows up their account. Determine your acceptable risk to reward ratio and incorporate this into your risk management strategy. Getting an edge is the key – all long-term successful traders have it.

Money management is the other major aspect of trading. Many traders use the 2% rule; whereby they put 2% of their capital as deposit for one trade. That is great in theory as it means you can have a drawdown of 50 straight losing trades (although probability would suggest that extent of bad luck isn't likely). Some will even put less than 2% down; at the end of the day it's up to the trading style and strategy. Putting a large amount of your capital on one trade could make some quick and potentially sizeable profits, but there's just as much chance of blowing the account up in a very short space of time.

THE BEST TRADERS MAY ONLY GET

30–40%

OF HIS OR HER TRADES RIGHT

SUCCESSFUL TRADERS INCORPORATE

STOPS AND LIMITS

SUMMARY

There are many styles of trading but knowing a few basic principles and rules which you may consider following to help you get the edge:

- **Trade with the prevailing trend, whether it's positive or negative.** Buying high and selling higher or selling low and buying back at lower levels can be an excellent short term strategy
- **Never add to a losing position, only ever add to winning positions.** The long term buy and hold manual doesn't agree with this (ie averaging down), but if something's working then go with it
- Never move your stop if it looks like it's going to get activated, wait for a new signal and re-enter
- **Markets remain illogical longer than you can stay solvent.** Respect the technicals, the charts rationalise human behaviour and tell you what the market is actually thinking
- **Never fall in love with a stock.** Short term trading generally requires traders to act nimbly
- **Manage emotion; it's your worst enemy as a trader.** Walk away from the screen, take a cold shower, meditate, do what needs to be done to remove the emotion of incurring losses or making a sizeable profit
- **Entering a trade is easy, 90% of trading is about managing the position.** Profitable trades take care of themselves, managing losing trades is much harder. Good traders are effectively managers of bad trade
- Markets are forward looking, but sometimes having the ability to react can be much more profitable than prophesising