HOW TO DEVELOP A TRADING STRATEGY [PDF]

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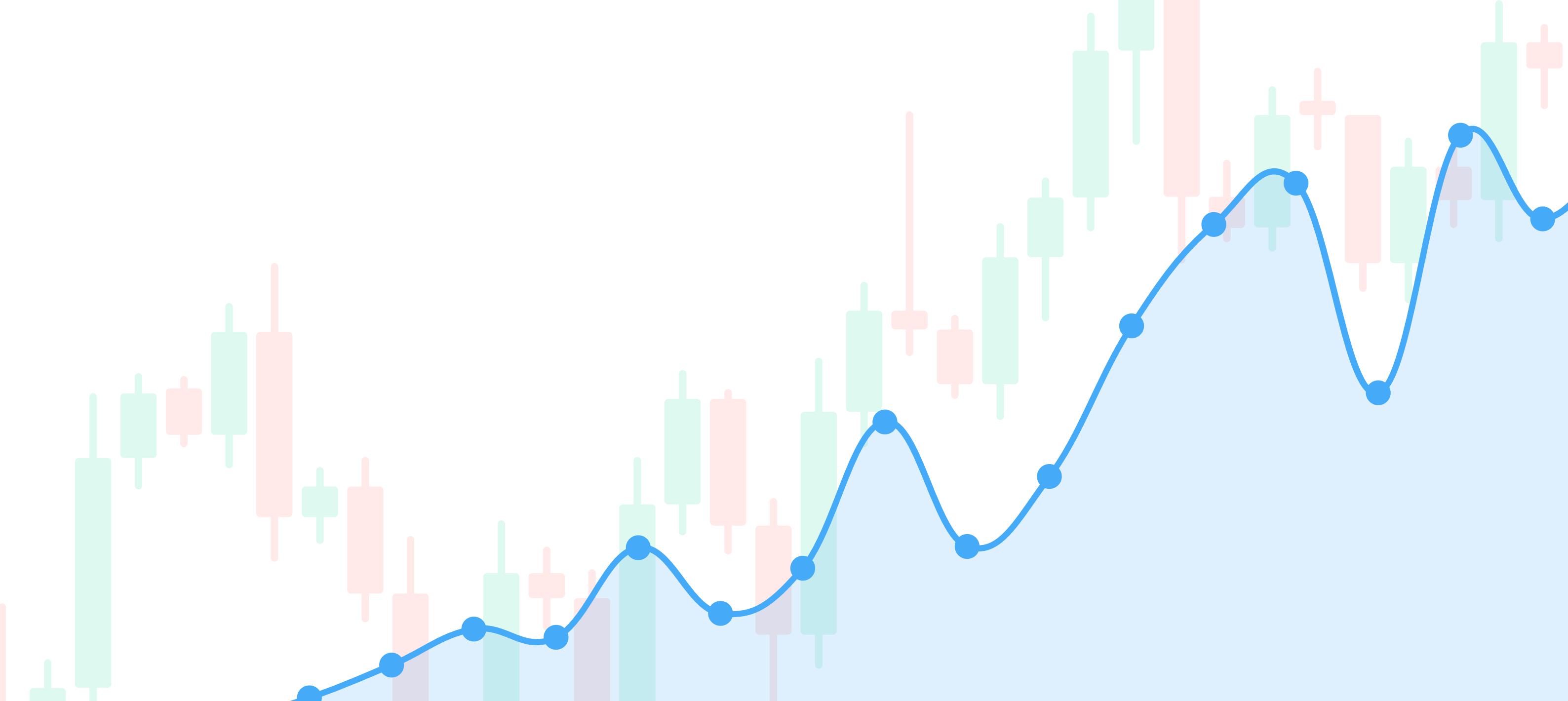

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What is a Trading Strategy?

A trading strategy is a systematic plan that guides buying and selling decisions in the financial markets. It typically includes defined entry and exit criteria, risk management rules, and the use of technical or fundamental analysis. Trading strategies help you avoid emotional decisions and stick to an objective approach, which can be backtested and improved over time.

It is important that you always approach trading with a strategy because it brings consistency and discipline to your trading. Instead of reacting impulsively to market fluctuations, a well-thought-out strategy allows you to follow predetermined rules and maintain focus on long-term profitability.

Steps on How to Develop a Profitable Trading Strategy

These are the steps you need to take to develop your trading strategy:

1. Choose an ideology

Choose how you want to see the market. Do you want to see it through the lens of chart patterns, candlestick patterns, harmonic patterns, Wyckoff patterns, smart money patterns, or even ICT patterns? Each of these ideologies has tools with which you can piece together trading decisions on the potential direction of the market.
It's also common for some of the tools from one ideology to fade into another. However, it's important to choose just one ideology to focus on. There can be borrowed concepts everywhere, but choose one ideology as the main focus.

We have enough resources for each trading ideology you may want to follow.

- Chart Pattern Trading
- Candlestick Pattern Trading
- Wyckoff Pattern Trading
- Harmonic Pattern Trading
- Indicator Trading
- Smart Money Concept Trading
- Inner Circle Trading

2. Determine how much time you want to spend trading

The amount of time you intend to spend trading is very important because it'll eventually determine your trading style.

Day traders, for instance, spend a lot of time on the chart because they trade the smaller timeframes, and each candlestick takes little time to form. As a result, things are happening so fast that they need to stay focused on the charts to catch their opportunities.

Swing traders tend to spend less time on the chart because they're usually on timeframes higher than the 4-hour. That means the least time it takes for a candlestick to form is 4-hours. So, there's more than enough time to spend off the charts. That's why swing trading is perfect for traders who can afford to spend a few minutes on the chart every day.

Position traders can hold trades for weeks or even months. They only need to check the charts once per day because they're trading a minimum of the daily timeframe.

Here's everything you need to get started with each of these trading styles:

- Day Trading Strategy – How to Get Started
- Swing Trading Strategy – What Is It and How to Get Started
- Position Trading – Everything You Need to Know About This Trading Strategy

3. Choose your trading approach

There are two common approaches to trading: technical and fundamental analysis. While these two are the most popular, other approaches include sentiment analysis, high-frequency trading, and arbitrage trading.

A technical approach requires that you try to predict market movement based on technical tools, such as technical indicators, supply and demand zones, chart patterns, trendlines, etc. Fundamental analysis involves predicting potential price moves using news events, economic data reports, political and financial interrelationships, etc.

Fundamental analysis is usually a great way to predict the longer-term price movement. However, it won't give you precise trade entry opportunities. However, technical analysis is a great tool for maximizing your profit margin as you can predict when and where to enter trading positions. It tends to fail more often, though.

For instance, fundamental trading strategies tell you that the price of a currency pair will rise for a while because of the interest rate differential between them. But it doesn't say when or where to enter the trade. Technical trading strategies tell you that the trend has changed from bearish to bullish at a particular price point, and you expect the price to only keep rising afterward.

Understand that you don't necessarily have to pick one of these approaches and dump the other. There are traders who do that with great success, and you can, too. But there are also traders who use both approaches with just as great success. We're just saying you can always combine both.

4. Start with one market and one instrument

The trading ecosystem is filled with thousands of trading instruments from various markets. There are currency pairs in forex trading, thousands of stocks on various stock exchanges worldwide, futures and options contracts, and so much more.
When you're developing your trading strategy, limit the noise. Choose just one market and one trading instrument to start with. When you get good with that, you can expand to more instruments within the same market. And once you generally get good with the market, you can port into another market.

Don't forget that markets everywhere tend to behave the same way, with some markets having some details and nuances that make them slightly different. So, if you get good with one instrument and one market, you can always transfer your strategy elsewhere. And with a few tweaks, you can also start getting successful there.

How do you know which one to pick? Honestly, just pick anyone. Forex is a good place to start for most beginners because it is very liquid, and things are always happening.

5. Choose your tools

We already discussed your trading ideology in the first step. However, each ideology has many other trading tools to choose from. For instance, if you choose to go through the chart pattern route, there are over 30 chart patterns to choose from. Common examples are the Heads and Shoulders and Double Top.

We strongly recommend you don't use all of them. Instead, you need to find those that appear often enough and try to work with them. Similarly, the ICT ideology, which has become more popular recently, has various concepts, such as fair value gaps and order blocks. Harmonics have the crab pattern and butterfly pattern. Indicator trading has hundreds or thousands of indicators. Some of the most popular are the MACD and the Moving Averages.

The beautiful thing about trading tools is that they tell you little stories about the instrument you're trading. They're like puzzle pieces you must combine before solving the puzzle of where the price will likely go next. Most of them have predefined entry and exit rules, which brings us to the next step.

6. Define your entry criteria

This is where the rubber meets the road. But it's impossible to get here if you haven't chosen a market ideology, a market approach, how much time you have to trade, your market and instrument, and your trading tool.

A well-defined entry helps you avoid impulsive decisions, keeping your strategy disciplined and objective. How, then, do you go about it? First, you determine the market condition.

Most times, you will be trend trading or range trading. Different strategies work better in different conditions. For example, in a trending market, you might use moving averages to time entries, while in a ranging market, support and resistance levels may guide your decision.

Timing is also crucial, especially for intraday traders. Avoid entering trades during market noise or low-volume periods. Instead, focus on key trading hours like the opening of major markets (London, New York) or at specific ICT Kill Zones when liquidity increases.

7. Define your exit criteria

What will you do WHEN the trade doesn't go your way? You cut your losses. And counterintuitively, how do you exit a trade when it's going your way because it won't continue to go your way forever? These are why you MUST have your exit criteria.

Profit-taking points should be based on the structure of the market. Common methods include using key resistance levels in an uptrend, Fibonacci extensions, or price objectives based on a fixed reward-to-risk ratio. For example, you might aim for a 2:1 reward-to-risk ratio, meaning you aim to make $200 for every $100 risked.

The placement of your stop loss depends on your strategy. For instance, you might place it below recent support in a long trade or above resistance in a short trade.

8. Define your risk

Your trade setup is incomplete if you don't know how much you risk. What works for most traders is to set a fixed percentage of your account balance that you're willing to lose on a single trade. A common rule of thumb is to risk no more than 1-2% of your total capital per trade. This helps ensure that your account won't be wiped out even if you face a series of losing trades.

When you know how much you're willing to risk and the size of your stop loss, you can then size your position accordingly. You can use a [position sizing calculator] to determine how many shares, lots, or contracts you can trade without exceeding your risk limit.
Also, avoid concentrating all your trades on a single asset class or currency pair. Diversification helps spread risk across different markets, minimizing the impact of a single bad trade.

9. Test and optimize your strategy

Most strategies will be poor when you first try them out. However, you don't just stop there. You try to figure out patterns in your losses so that you can learn how to limit them. Also, you need to observe patterns in your wins to learn how to improve them.
Once you have something that gives you a consistent monthly profit, you can take it to a demo account. If you're successful there, you can move to a small live account, where your emotions will be tested.

Extra Tips on Developing Your Trading Strategy

Let's take a look at these extra tips for developing your trading strategy:

1. Don't look for the perfect strategy. It doesn't exist

It's as simple as that. No strategy will give you a 100% win rate. If you see a YouTube thumbnail telling you a strategy has a 100% win rate, don't bother watching the video. It's either clickbait, or the YouTuber hasn't tested the strategy over enough number of trades. Even hedge fund managers and big institutional traders who are known to influence market price directions lose money. A recent example was the Gamestop saga.

2. It's going to take time and consistency

Developing a trading strategy will require much time and consistency from you. It may take as long as months to get something that works and then years to become consistently profitable using it. If you're not ready to pay that price, you're better off buying a course that teaches an already predefined strategy. Even then, you'll still need time and consistency to practice it to the point where it works for you.

3. Every strategy is bad on the first trial.

Chances are that your strategy is bad when you first try it out. And that's absolutely normal. Don't be quick to discard this strategy, though. See if you can refine it. Try to see what's causing it to fail, eliminate it, and then test it again. Keep up with this iteration, and you'll eventually find some success with it.

4. It doesn't have to be your own trading strategy from scratch

One of the mistakes most traders make when trying to build their trading strategy is trying to come up with it from scratch. We hate to disappoint you but there are no new ideas. Most trading strategies are offshoots of other trading strategies. Whatever strategy you intend to come up with will rely on some ideas someone else has had.
So, you can lean into this by learning a strategy first and then trying to optimize it to your liking.

5. Stick to your strategy

Your strategy is not poor if you have a losing streak. Every strategy has losing streaks. It's only poor if it proves unprofitable over many trades. So, if you're going through a losing streak, don't be quick to blame it on your strategy. It may be because you're taking more impulsive trades without waiting for your trading plan to play out or simply because the market is not favorable for your strategy at the moment.