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TRADING RULES

INTRODUCTION

A very small percentage of all traders are successful.

Yet, some traders accumulate more than 1 million dollars in trading profits.

What do the successful traders do differently?

Searching for the answer to this question is what prompted interviews with several millionaire traders.

Some of the rules that millionaires use are familiar to all traders.
Others may be contrary to the common beliefs.

"The most important factor is not what set of rules you use, but your discipline", noted one of the traders interviewed.

These are the rules that were generated from the interviews with
the millionaires.

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First of all for conducting the interviews with the millionaire
traders and secondly for editing them down into such a presentable and readable format.

In particular I would like to single out one

and my trading in general.

RULE #1 -Use Money you can afford too loose

If you are trading with funds you need for some family project, you are doomed to failure.
This is because you won't be able to enjoy the mental freedom to make sound trading decisions, say the millionaire traders.
Your trading funds should be viewed as money you are willing to lose.
Your position should be carefully analyzed so you don't jeopardize other funds or assets.
One of the keys to successful trading is mental independence.
"You've got to trade outside influencing factors, and that means your trading freedom must not be influenced by the fear of losing money you really have earmarked for a specific need", said one trader.

"The market place is not the arena for scared money", agreed another.

RULE #2 Know yourself

You need an objective temperament, an ability to control emotions and carry a position without losing sleep.
Although trading discipline can be developed, the successful traders are unemotional about their position.
Learn about developing discipline and removing emotional trading.
Successful traders suggest that people who can't control emotions look elsewhere for profits.
"There are many exciting things happening in the market everyday, so it takes a hard-nosed type of attitude and an ability to stand above short-term circumstances.

If you do not have this attitude you will be changing your mind and your position every few Minutes", noted one of the millionaires.

RULE #3 - Start small

Test your trading ability by making paper trades. Then begin to trade small.
If you are trading emini contracts, trade a single contract. If you are trading commodities trade small lots of 1000 to 3000 bushels of grain at a time.
If your broker doesn't allow you to trade in small lots or single contracts, start with something less volatile, e.g. in commodities trade oats.
Beginning traders should learn the mechanics of trading before graduating to more volatile Contracts.

RULE #4 - Don’t over commit

One rule of thumb is to keep three times the money in your margin account than is needed for that particular position.

Reduce your position if necessary to conform to that rule.

This rule helps you avoid trading decisions based on the amount of money in your margin account.

If you are under-margined you may be forced to liquidate a position early, at a costly loss that could have been avoided.

Click here to learn more about margin and the futures market in general.

RULE #5 - Isolate your trading from your desire for profit.

Don't hope for a move so much that your trade is based on hope.
The successful trader is able to isolate his trading from his emotion.
Although hope is a great virtue in other areas of life, it can be a real hindrance to a trader." said once trader.
When hoping that the market will turn around in their favor, beginners often violate basic trading rules.

RULE #6 - Don’t form new opinions during trading hours.

Decide upon a basic course of action, then don't let the ups and downs during the day upset your game play.
Decisions made during the trading day based upon a price move or a news item are usually disastrous, say the millionaires.
Successful traders prefer to formulate a basic opinion before the market opens, then look for the proper time to execute a decision that has been made - apart from the emotion of the current market.
When a trader completely changes his direction during the trading day, it can confuse him and may result in generating lots of commissions with little profit.

RULE #7 -Take a trading break

Trading every day begins to dull your judgement.
One successful trader commented:
"When I fall to 90% of mental efficiency, I begin to break even. Anything below that I begin to lose."
This trader takes a complete trading break every five or six weeks. If he has been successful he goes to Florida, if not he stays in Chicago.
A trading break helps you take a detached view of the market, and tends to give you a fresh look at yourself and the way you want to trade for the next several weeks.
"Sometimes you get so close to the forest you can't see the trees," said one trader.
"A break helps me see the market factors in a better perspective."

RULE #8 -Don,t follow the crowd.

Successful traders like breathing room. When everyone seems to be long, they look for a reason to be short. Historically, the public tends to be wrong.
Successful traders feel uncomfortable when their position is popular with the buying public, especially small traders.
Periodic government reports on the position of traders of various sizes provide "overcrowding" clues. Another clue is "contrary opinion".
When most of the advisory services are long, for example, the successful trader gets ready to move to the sideline or to take a short position.
Some services give a reading on market sentiment determined by compiling opinions from many advisory services.
If 85% of the analysts are bullish, this indicates an overbought situation. If less than 25% are bullish, this indicates an oversold condition.

RULE #9 - Block out other opinions

Don't be influenced in your trading by what someone says, or you will continually change your mind.
Once you have formed a basic opinion in the market direction, don't allow yourself to be easily influenced.
You can always find someone who can give you what appear to be logical reasons for reversing your position.
If you listen to these outside views, you may be tempted to change your mind only to find later that holding your opinion would have been more profitable.

RULE #10 -When you’re not sure, stand aside.

Don't feel that you have to trade every day, or even hold a position every day.
The beginning trader is tempted to trade or hold a position every day and this is a costly tendency.
The successful traders develop patience and discipline to wait for an opportunity.
After they have taken a position and begin to feel uncomfortable, successful traders either reduce the size of the position or liquidate.

RULE #11 - Try to avoid market orders.

Putting in an order to buy or sell at market may show a lack of discipline, according to one successful trader.
To avoid violating this rule, he places specific price limit orders.
However there are times when he wants to liquidate a position immediately. Then the market order is helpful.
Your goal should be to minimize the use of market orders.

RULE #12 - Trade the most active month

If you are trading emini contracts, there are contracts expiring in March, June, September and December. The nearest month is usually the most active contract until the last few days before expiry.

If you are trading commodities, trade the contract with the highest volume and open interest. For example with soybeans, November, March and July usually have the highest volume and open interest, depending on the season.

Trading these active months should enable you to get in and out easily.

A similar caution should be noted for inactive commodities. Low volume commodities are not the markets for beginning traders because it may be difficult to liquidate a position when you want out.

A good broker will be able to give you help in this area

RULE #13 -Trade divergence between related commodities

When trading commodities, watch the "families": grains, the meats or the metals.
When you spot a wide divergence in a group, it could signal a trading opportunity.
For example, if all grains except soybeans were moving higher, the millionaire traders would look for an opportunity to sell soybeans as soon as the grains in general appeared to be weakening.
The reverse of this is true also.
The traders would buy the strongest commodity in the group during periods of weakness.

RULE #14 - Don't trade too many

You'll hurt yourself if you try to have the necessary information and "feel" of several different markets, e.g. both stock and futures markets.
Know your limitations and trade within these limits. Few traders successfully trade multiple markets at the same time, because they are moved by independent factors.

RULE #15 -Trade the opening range breakout

This is a good price-direction clue, particularly after a major report. A break out of the opening range may tell you the direction of trading for the day or the next several days.
If the market breaks through the opening range on the high side, go long. If it breaks out on the bottom side of the opening range, go short.

RULE #16 Trade the breakout of previous day’s range.

This rule is used by many successful traders to decide when to establish or lift a position.

It means never buy until the price trades above the previous days close, or never sell until the price trades below the previous day's close.

Followers of a "market momentum philosophy" use this rule. They believe that the weight in the market is in their favor when they wait for trading to break out of the previous day's trading range before adding to their position.

RULE #17 -Trade a weekly breakout

This rule is similar to the daily rule, except it is used on weekly highs and lows.

A break of the weekly range can be seen as a signal of the trading direction for several weeks to come and can therefore be considered a stronger signal.

RULE #18 -Trade a breakout of the monthly range.

The longer the period you're watching, the more the market momentum behind your decision. So monthly price breakouts are an even stronger clue to price trends and are vitally important for the position trader or hedger.
When the price breaks out on the topside of the previous monthly high, it's a buy signal. When

the break out is on the bottom side of a previous monthly low, it's a sell signal.

RULE #19 - Build a trading pyramid

When you add to a position, don't add more contracts at any one time than the number of contracts you already have open. For example if you're trading emini, let's assume your initial position was 4 contracts. An ideal situation would be to pyramid by adding 3 contracts then 2 contracts, then 1 contract, providing the market is moving your way.
Try to avoid the "inverted pyramid" type of trading where at each addition you add more than your original position. This is a dangerous trading technique because a minor market reversal can wipe out your profit for the entire position. Your average price is closer to market price in the "inverted pyramid" situation, which makes you vulnerable.

Another danger in pyramiding is that of over-committing yourself to the point where you lack sufficient margin money.

RULE #20 - Never enter your entire position at one price.

If you want to be long a certain number of contracts, or a certain number of shares, you may want to do it 4 or more installments, to see if the market is moving in your direction before you become totally committed.
Successful traders use the fundamentals and various technical signals to guide their trading, but the most important key is market action.
The millionaire traders tend to wait for the market to verify that the initial position was a good one before putting on their full position.

RULE #21 -Never add to a losing position

Regardless of how confident you feel, if you establish a position that shows a loss, don't add to it.
It may mean that you are out of step with the market.
Some traders don't agree with this rule, believing in a "price averaging" technique.
The millionaire traders interviewed believe this is a risky technique and a way to mentally justify adding to a position that only magnifies a mistake.
This sometimes goes back to the "hoping" method mentioned in Rule No 5.

RULE #22 -Cut your losses short.

When the market moves against you, admit your mistake by liquidating your position.
You can be successful if you are right on less than 50% of your trades if you keep your losses short and let your profits run.
Some successful traders have only three or four profitable trades out of ten because through discipline or stop-loss orders they get out early when they are wrong.
One of the most common failures of new traders is their inability to admit they're wrong say millionaire traders.
It takes a great deal of discipline to overcome the temptation to hang on to a loss, hoping that the market will turn in your favor.

RULE #23 -Let profits run

Cutting your profits short can be the cause of unsuccessful trading.
The slogan "you never go broke taking a profit" doesn't apply. The reason: Your losses will at the best cancel out or at worst outweigh your profits unless you let your profits run.
How do you know when to take a profit? Some technical rules on reversals and other chart formations can help.
The millionaire traders say you should never take a profit just for the sake of a profit - have a reason to close out a profitable position.

RULE #24 -Be impatient losing positions.

Never carry a losing position more than two or three days and never over a weekend say the millionaire traders.

This rule is used by one of the successful traders as a way to force discipline.

"Although it sounds very simple to say 'Cut your losses short', it's a tough area even for seasoned traders", he says.

"That's why I make a flat rule for myself on carrying losses.

Over the last two or three years, blindly following this rule has saved me from some huge losses."

RULE #25 -Learn to like losses.

This rule says just the opposite of what many traders think.
One successful trader says:
"Learn to like losses because they're part of the business.
When you gain the emotional stability to accept a loss without it hurting your pride, you're on your way to becoming a successful trader."
The fear of taking a loss must be removed before you become a good trader.