HOW TO ACHIEVE SUCCESS IN FINANCIAL MARKETS

Step by step guide

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What are Financial Markets?

They create liquidity that allows businesses to grow and entrepreneurs to raise money for their ventures. These include stocks, bonds, derivatives, foreign exchange, and commodities.

Stock market is a place where shares of pubic listed companies are traded. The primary market is where companies float shares to the general public in an initial public offering (IPO) to raise capital. Once new securities have been sold in the primary market, they are traded in the secondary market—where one investor buys shares from another investor at the prevailing market price or at whatever price both the buyer and seller agree upon.

The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements. Publicly-traded companies issue bonds when they need to finance business expansion projects or maintain ongoing operations. The general bond market can be segmented into the following bond classifications, each with its own set of attributes: Government Bonds, Municipal Bonds, Mortgage-Backed Bonds and Emerging Market Bonds.

Derivatives are complicated financial products that base their value on underlying assets. Sophisticated investors and hedge funds use them to magnify their potential gains. In 2007, hedge funds increased in popularity due to their supposed higher returns for high-end investors. Since hedge funds invest heavily in futures, some argued they decreased the volatility of the stock market and, therefore, the U.S. economy.

Forex trading is a decentralized global market in which currencies are bought and sold. About $6 trillion are traded per day and 88% involved the U.S. dollar. Almost one-fourth of the trades are done by banks for their customers to reduce the volatility of doing business overseas. Hedge funds are responsible for another 11%, and some of it is speculative.

A **commodity** market is where companies offset their futures risks when buying or selling natural resources. Since the prices of things like oil, corn, and gold are so volatile, companies can lock in a known price today. Since these exchanges are public, many investors also trade in commodities for profit only. For example, most investors have no intention of taking shipment of large quantities of pork bellies.

Futures are a way to pay for something today that is delivered tomorrow. They increase a trader's leverage by allowing him or her to borrow the money to purchase the commodity.

Different Types Of Trading Strategies

Buy and hold is a passive investment strategy in which an investor buys stocks (or other types of securities such as ETFs) and holds them for a long period regardless of fluctuations in the market. An investor who uses a buy-and-hold strategy actively selects investments but has no concern for short-term price movements and technical indicators. Many legendary investors such as Warren Buffett and Jack Bogle praise the buy-and-hold approach as ideal for individuals seeking healthy long-term returns.

Trend following or trend trading is a trading strategy according to which one should buy an asset when its price trend goes up, and sell when its trend goes down, expecting price movements to continue. There are a number of different techniques, calculations and time-frames that may be used to determine the general direction of the market to generate a trade signal, including the current market price calculation, moving averages and channel breakouts. Traders who employ this strategy do not aim to forecast or predict specific price levels; they simply jump on the trend and ride it.

A **mean reversion** trading strategy involves betting that prices will revert back towards the mean or average. This is a theory first observed by statistician Francis Galton and it explains how extreme events are usually followed by more normal events. A simplistic example of a mean reversion strategy is to buy a stock after it has had an unusually large fall in price. In other words, things tend to even out over time.

Day trading is a stye of trading in which traders open and close positions on the same day. Day trading strategies tend to be more action packed and require traders to be present at their trading station throughout the session, monitoring the live price charts. It is widely accepted that the narrower a time frame a trader works in, the more risk they are likely to be exposed to, meaning that day trading is one of the riskiest approaches to the financial markets. It is not necessarily that the different strategies themselves carry more risk. In fact, the overall logic is the same for almost any time interval that exists. However, day trading rules tend to be more harsh and unforgiving to those who do not follow them. Mistakes are more costly and they have the potential to occur more frequently, since the act of trading itself is occurring more frequently.

Meet Some of The Most Successful Traders

Warren Buffett has been working with his long-time friend and business partner, **Charlie Munger**, for over 40 years. Clearly, their relationship has been a successful one, judging by Berkshire Hathaway's amazing track record of outperforming the overall stock market every year going back to the 1960s. As a result of their success together, Munger is now worth about $1.7 billion, according to a recent estimate by Forbes, while Buffett has a net worth of more than $84 billion, making him the third-wealthiest person in the world.

In 1983, legendary commodity traders **Richard Dennis** and **William Eckhardt** held the turtle experiment to prove that anyone could be taught to trade. The training would last for two weeks and could be repeated over and over. Dennis called his students "turtles" after recalling turtle farms he had visited in Singapore. According to former turtle Russell Sands, as a group, the two classes of turtles Dennis personally trained earned more than $175 million in only five years. Dennis had proved beyond a doubt that beginners can learn to trade successfully.

In the early 1970s, **Ed Seykota** was hired as an analyst by a major brokerage firm. He conceived and developed the first commercial computerized trading system for managing clients' money in the futures markets. Trading as a trend follower, Ed Seykota turned $5,000 into $15,000,000 over a 12 year time period in his model account–an actual client account. Ed was self-taught, but influenced early on in his career by Richard Donchian's writings.

Andreas Clenow is a Chief Investment Officer located in Zurich, Switzerland, overseeing many investment strategies over a nine-figure asset base. He is an author of international bestsellers titled *Following the Trend* and *Stocks on the Move.* These books present a quantitative approach to modelling the markets with extensive backtest results. You can also learn from the practitioner how hedge fund business looks from the inside.

Common Mistakes to Avoid When Starting a Trading Career

Adding to losing positions. Learn to take losses because they are normal. Trying to delay the realization of losses is the death sentence for your trading account.

Ignoring the importance of trading costs. According to research only about 1% of all day traders are able to predictably profit net of fees. Spread is the cost of doing business as a trader and, therefore, finding ways to minimize your costs should be high on your priority list.

Holding losers and selling winners. The so-called disposition effect which states that on average, traders sell winning trades 50% faster than they hold losing traders.

Expecting to become rich any time soon. The trading industry created the illusion that with enough leverage, the right trading strategy and some luck you can make a lot of money easily.

Following advice from random people. Never ever take trades based on opinions, tweets or promises made by other people unless they have proven track record.

Changing your trading strategy after 5 losing trades in a row. Losing is unavoidable and even the best traders will regularly realize losses. Changing your approach after a few losing trades sets you back on the learning curve.

Quotes Worth Remembering

Cut your losses short, and let your profits run on.

- David Riccardo -

If you can't take a small loss, sooner or later you will take the mother of all losses.

- Ed Seykota -

Expecting triple digits returns with low risk is not grounded in reality.

- Andreas Clenow -

Real knowledge is knowing that you don't know anything.

- Charlie Munger -

If you try to engineer all of the risk out of a trade, it will only surface somewhere else when it is least welcome.

- Perry J. Kaufman -

MARKETS ARE TRENDING ONLY ABOUT 20 PERCENT OF THE TIME

Stick with your bias