Let me ask you something, *what does a consistently profitable trader mean to you?*

You're probably thinking:

"I need to know when the best time to enter a trade is, I need to able to predict where the market is going, I need to buy low and sell high, I need to exit my trades at maximum profits, I need to win over 50% of the time etc."

But, do you need all these to become a consistently profitable trader?

The answer is, no. And you'll understand why by the time you complete The Price Action Trading Institute.

For now, there are more important things you must understand (if you want to be a consistently profitable trader).

And I'm going to share with you right now…

The law of large number and how it fools most traders

First, let's understand what the law of large number is…

The law of large numbers describes the result of performing the same experiment many times. According to the law, the average of the results obtained from a large number of trials should be close to the expected value and will become closer as more trials are performed. – Probability Theory

You're probably wondering, what does it mean?

To put it simply, when you're dealing with probabilistic events (like trading, horse betting, blackjack), your results are random in the short run…and will align to its expectancy in the long run.

For example:

You know a coin has 50% probability of coming up heads and 50% probability of coming up tails.

But if you toss a coin 6 times, what are the odds of you getting 50% heads and 50% tails?

Nowhere near 50% right?

But, what if you toss the coin 1000 times?

What are the odds of you getting 50% heads and 50% tails?

In this scenario, you're much closer to getting 50% heads and 50% tails.

This phenomenon is the law of large number.

And this has a major implication on your trading because it means your trading results are random in the short run.

Imagine this…

You learn a new trading strategy and start to trade with it.

After 5 trades, you realize you're losing money and you conclude the trading strategy isn't working.

Then, you look for a new trading strategy again.

Now, tell me what's wrong with this?

You conclude that your trading strategy doesn't work based on a small sample size of trades (which is random in the short run).

In short, you're being fooled by randomness.

So, how do you overcome this?

Here's what I suggest… whenever you adopt a new trading strategy, trade it a minimum of 100 times before concluding whether it works or not.

This way, you'll have a lesser likelihood of being fooled by randomness.

You need money to make money

Here's the truth…

In this trading business, you need money to make money.

This means it's easier to make $10,000 with a large account compared to a small account.

For example:

On a \$1m account, you need a return of 1% to make \$10,000.

But on a \$1000 account, you need a return of 1000% to make \$10,000.

Which is easier… to make 1% or 1000%?

So…

Forget about getting rich quick.

Forget about taking hundreds of dollars and turning it into millions quickly.

Forget about trading for a living with a small stake.

The odds are you'll blow up your account before anything else.

Instead, learn how to manage your expectations accordingly.

If you make an average of 20% a year (depending on your risk appetite and trading style):

On a \$1000 account, you're looking at an average of \$200 per year.

On a \$100,000 account, you're looking at an average of \$20,000 per year.

On a \$1m account, you're looking at an average of \$200,000 per year.

Get the picture?

This is important but most traders don't get it.

Find a trading style that suits you

Think about this:

Warren Buffet, considered the world's greatest investor, invests based on fundamental analysis only.

Ed Seykota, a Trend Follower, trades based on technical analysis only.

Mark Minervini, a stock market wizard, trades based on fundamental and technical analysis.

So what's my point?

My point is, there are different ways to speculate in the markets.

You need to find a trading approach that suits your personality, schedule, and lifestyle.

It doesn't make sense to be a day trader if you have a full-time job, right?

Many traders fall into the trap of copying someone else's strategy because they're making money with it.

But a more important question is, does the trading strategy suit you?

Here's what I suggest…

First, understand the different trading styles out there.

You can do so by reading books like *Market Wizards* and following traders on social media.

This gives you an idea of different trading methodologies.

Next… ask yourself which trading style suits your schedule.

For example:

If you have a full-time job, then day trading will not make sense for you.

That's because you can't devote the hours required. Instead, trading the higher timeframes like the Daily would be appropriate.

On the other hand, if you have all the time in the world and enjoy watching the markets tick by tick, then position trading won't suit you.

You'll probably micromanage your trades on the shorter time frames and miss the longer term move. Instead, being a day trader or scalper would make sense.

Then, find a trading strategy that exerts minimum mental capital.

Here's the thing: Most traders don't quit trading because of blown up accounts (they can always fund it again). They quit because they've lost their mental capital entirely.

One way you can minimize your mental capital is to adopt a trading strategy that you're comfortable executing consistently.

For example: If you prefer to trade pullbacks, then look for trading strategies that capitalize on pullbacks.

Or, if you like trading breakouts, then adopt trading strategies that capitalize on breakouts.

There’s no right or wrong here, but you must know your psychological strength & weakness and trade it accordingly.

Lastly, to reduce your learning curve, **find a proven trader whose trading style makes sense to you and copy him**.

There’s no need to try and reinvent the wheel.

You can be more wrong than right and still make money

New traders think they need to be correct more than half the time to make money. But is this true?

Consider this for a moment…

Let’s say you have a trading system with a winning ratio of 30%.

This means that you’ll be wrong 7 out of 10 times, and be right only 3 out of 10 times.

That may sound like terrible odds and most people are convinced they could not make money with odds like that. But they would be wrong.

Let’s say that every time you are wrong, you lose $100, and every time you win, you make $500.

Let’s do the math:

7 x $100 = $700 loss

3 x $500 = $1,500 gain

Net profit = $1,500 (gain) minus $700 (loss) = **$800 profit**

In fact, even if your losses were twice as much, let’s say you lost $200 every time you were wrong, you would still be in net profit after 7 losses:

Net profit = $1,500 (gain) minus $1400 (loss) = **$100 profit**

Clearly, it’s not whether you’re right or wrong that matters. But, how much money you make when you’re right, and how much you lose when you’re wrong.

Now, taking this a step further, you can calculate the expectancy of your trading strategy using the formula below:

E= [1+ (W/L)] x P – 1

Where:

W means the size of your average wins
L means the size of your average loss
P means winning rate

Here's an example:

You have made 10 trades. 6 were winning trades and 4 were losing trades.

That means your percentage win ratio is 6/10 or 60%.

If your six trades brought you a profit of $3,000, then your average win is $3,000/6 = $500.

If your losses were only $1,600, then your average loss is $1,600/4 = $400.

Next, apply these figures to the expectancy formula:

E= [1+ (500/400)] x 0.6 – 1 = 0.35 or 35%.

In this example, the expectancy of your trading strategy is 35% (a positive expectancy).

This means your trading strategy will return 35 cents for every dollar traded over the long term. *Recall the law of large number?*

Think in terms of R

Have you ever seen statements like these?

Discover how I made 300 pips this week!

Look, I made a return of 50% in a month!

Learn how to make 3000 pips consistently!

I'll be honest with you.

Those are marketing gimmicks trying to part you and your money.

The problem with statements like these is, you don't know the level of risk taken to achieve those results.

For example:

If you want to make 300 pips a week, just trade an exotic pair like USD/MXN and have a stop loss of 3000 pips.

You have a high probability of getting 300 pips since your stop loss is larger relative to your profit target.

Or how about making 50% a month?

Well, that's easy too. You need only to risk your entire account on a single trade, and if the market goes half way in your favor, you'll be up 50%.

But the question is, can you do this every single month without eventually going belly up?

Of course not.

So, a better way to look at your trading results is in terms of R (a concept that's originated from Dr. Van Tharp)

R is defined as your initial risk on each trade, either in nominal value or percentage terms.

For example:

You risk $100 on a trade, so this $100 represents 1R to you. Or, if you risk 1% of your account, the 1% represents 1R to you.

Taking this a step further, if you risk $100 on a trade and made a profit of $300, it's a gain of 3R (300/100=3).

If you risk 1% and you made a gain of 5%, it's a gain of 5R (5/1=5).

Does it make sense?

Using the R concept makes your trading objective.

Instead of calculating how many dollars you made, or what percentage you gained, a better metric would be the R-multiple.

This is an objective measure as it considers the gains relative to your risk.

Risk management is your key to survival

I used to get excited about the latest trading strategies, systems, and entries.

But after years of trading, I realized these don't matter if you don't have proper risk management.

You can have a great trading strategy, but without proper risk management, you will still blow up your trading account. It's not a matter of if, but when.

Here's an example:

Let's assume you have a trading strategy that wins 70% of the time and loses 30% of the time — and you make $2 for every dollar risk.

You start with a $10,000 trading account, and the outcome of your next 10 trades is:

Lose Lose Lose Win Win Win Win Win Win Win

You're an aggressive trader who believes in go big or goes home.

So, you risk $4000 on each trade and **you lost everything by the 3rd trade** (-4000, -4000, -4000).

But what if you're a responsible trader, who risks $100 on each trade? How would that change?

Well, **you made a gain of $1100** (-100, -100, -100, 200, 200, 200, 200, 200, 200, 200)

Now, can you see why risk management is important?

Because without it, even a profitable trading strategy will not make you money in the long run.

Your trading strategy must have an edge

First, let's define what an edge is.

Your trading strategy has an edge if it produces a positive expectancy in the long run.

This is important because, without a positive expectancy, even the best risk management and discipline will not make you a profitable trader.

Don't believe me?

Try gambling at a casino. You can apply the best risk management and discipline, but eventually, the casino will come out ahead of you. Why? Because it has a statistical edge over you.

Now, you're probably wondering: "How do I get an edge in the markets?"

To answer that question, you must first understand trading is a zero-sum game (excluding transaction costs).

This means for one trader to profit, another must lose.

So, for a trading strategy to have an edge, it must profit from losing traders.

For example:

If a breakout of new highs occurs, the trader who longs the breakout will profit from the trader who shorts the high (in anticipation of a reversal).

Likewise, if the market reverses from the highs, the trader who shorts the high will profit from the traders who long the breakout.

Now, there's no right or wrong whether you want to trade breakout or pullback.

What's important is, to understand who is on the opposite side of your trade, and how you're profiting from them.

If you have no idea, then chances are, you're the losing trader.

Warren Buffet once said: "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy." Don't be the patsy.

You must have the correct psychological makeup

Earlier you've learned you need proper risk management and a trading strategy with an edge if you want to be a consistently profitable trader.

However, this isn't enough.

You still need one last ingredient, the correct psychology – and it's possibly the hardest one to master.

Here’s why…

- Small trading account
- Hate to be wrong
- Lack of discipline

Small trading account

So, you want to be a trader because you want to make tonnes of money, trade for a living, and having no one to answer to, right?

But the fact is, in this business, you need money to make money.

A mistake most traders make is stepping into this business with a small trading account, hoping to turn it into millions.

Because if they followed proper risk management, it will take them many years to make it big.

Example:

You have a $1000 account and you risk 1% on each trade.

This means the max loss on each trade (excluding slippage) is $10.

Even if you get a 1 to 5 risk to reward, it’s only a gain of $50.

This sounds like paltry sum after spending so much time learning how to trade, right?

And this is a psychological issue a trader face because you put in hard work into your trading, only to get back small returns (in nominal value).

So what will you do?

You risk more hoping to make more money (trying to justify the time you spent learning how to trade).

Then what happens?

Eventually, you blow up your trading account as you’re risking too big relative to your account size.

And here’s the thing, having a small trading account is not an excuse to bet the farm because that’s gambling and not professional trading.

My suggestion is this…

Learn to think of your gains/losses in terms of R instead of a dollar figure.

This makes your trading performance objective, so if you want to make more money, it's a matter of scaling up your account size accordingly.

Remember, a 10% gain on $1000 account is $100. But on a $1m dollar account, it's $100,000.

Hate to be wrong

Imagine this:

You spent many days trying to solve a problem, and when you finally come up with a solution, someone says you are wrong.

How will you feel? Like crap right?

And it's the same thing in trading the financial markets.

You've analyzed the markets, the chart looks good and fundamentals are in your favor.

You know when to enter, when to exit, and how much to risk.

So, you put on a trade but… it immediately goes against you.

Then, you harbor thoughts like "the market is wrong, it's going to reverse soon, it can't go any lower".

So, what do you do?

You hold onto your losing trades hoping it will reverse and prove you right.

Most of the time, it does what you hoped for.

But, the one time it doesn't, you lose your trading account (because you hate to be wrong).

And this is one reason why traders consistently blow up their trading account.

So here's the thing…

In trading, you can be more wrong than right and still make money.

It’s not whether you’re right or wrong that matters. But, how much money you make when you’re right, and how much you lose when you’re wrong.

Lack of discipline

Richard Dennis, founder of the turtle traders said…

“I always say you could publish rules in a newspaper and no one would follow them. The key is consistency and discipline.”

So, why is it difficult to be disciplined?

The answer is, we let our emotions cloud our judgment.

Let’s say, you trade with a new strategy and had a few winners at the start.

Then you experience losing trades and you start to doubt the strategy.

So what do you do?

Chances are, you’ll change trading strategy thinking the previous one isn’t working and look for the next best thing (but if you understand the law or large number, you know the short-term results don’t mean a thing).

And with the rise of social media, it gets even harder to be disciplined for a new trader.

Why?

Because you see social media traders posting their P&L on Facebook and you think to yourself, *Wow, he’s trading strategy seems to make profits all the time, I should use their strategy instead*.

So, you take up a course or something, only to realize their trading strategy has losing streaks as well.

Unknowingly to the trader, he thinks the trading strategy has stopped working and he’ll look for the next best thing, again.

This vicious cycle will repeat itself till you get the “AHA” moment, or quit trading altogether.

Remember, an inconsistent set of actions will give you inconsistent results.

If you want to be a consistently profitable trader, you must have a consistent set of actions — and the only way to achieve it is, be disciplined in your trading.

How consistent you are depends on your trading frequency

Let’s be honest, who doesn’t want to make money from trading every day?

And you’ve learned that to be a consistently profitable trader, you need a trading strategy with positive expectancy, proper risk management, and discipline.

However, there’s one last ingredient that’s seldom talked about, and it has a huge impact on your trading consistency.

What is it? It’s your trading frequency. Let me explain why…

Earlier, you’ve understood that your trading is affected by the law of large number.

This means in the short run, your trading results are random, and you need a minimum of 100 trades for your edge to play out.

So the question is, how fast can you execute 100 trades without compromising your edge?

High-frequency trading — If you trade at high frequency, doing thousands of trades each day, you can be consistently profitable every day. An example of such a firm is Virtu Financial.

Day trading — Day traders would do anywhere from 3 – 5 trades a day. Thus, you can expect to be profitable in most months.

Swing/Position trading — Swing traders would do anywhere from 10 – 20 trades a month. Thus, you can expect to be profitable in most years.

Trading consistency is a relative term and it varies from the trading method you employ.

There’s no one size fits all, instead, adopt a trading approach that suits you, and manage your expectations accordingly.

It doesn’t make sense to be a swing trader and expect to make money every day, right?

Summary

- Don’t hop from one trading strategy to the next after a few losses. Your trading results are random in the short run
- You need money to make money in trading and there are no two ways about it

- Find a trading style that suits your personality and time commitment
- You can be more wrong than right and still make money. That's because your wins are greater than your losses
- The R-multiple is an objective way to measure your trading performance
- The 3 ingredients to succeed in this business is having an edge, proper risk management, and discipline
- The greater your trading frequency, the greater your trading consistency (provided you have an edge in the markets)