SYSTEM TRADING WEBINAR

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Online

Ground rules

- Please mute yourself and switch off your video(webcam). If you don't, all attendees can see you in your pajamas/shorts ☺
- Kindly note down your question and ask at the end of each session. There will be ample time for Q&A (one in the morning session and another in the afternoon session)
- If you are planning to screen record this session today, DON'T – two reasons

1. Unique video watermark(alphanumeric char) in your screen will enable us to know who you are (like your username and IP address). You might just share it with your friend casually for his personal use but if he shares it in public, it will create issue for you.
2. For your personal use, I will be sharing 1 week of recording anyways. So, lets not complicate things today ☺

Webinar timings break-up

- Morning 1st session → 9:30AM to 11AM

  Tea Break → 11AM to 11:15AM

- Morning 2nd session → 11:15AM to 12:00PM
- Morning Q&A → 12PM to 1PM

  LUNCH BREAK→ 1PM to 2PM

- Afternoon 1st Session → 2PM to 3:30PM

  Tea Break → 3:30PM to 3:45PM

- Afternoon 2nd Session → 3:45PM to 4:30PM
- Afternoon Q&A → 4:30PM to 5:30PM

MORNING SESSION

Common misconceptions about Trading

- Get rich quick scheme – quick money
- Trading is easy (it is simple though)
- Pros has a ‘secret technique’ to make money
- If X can make 50% returns, I can also do the same immediately
- More screentime = more profitability
- Complex strategies outperform simple one ☺
- Need PhD/MBA/ fancy certifications/super smart
- If I learn more, I can control my returns in the markets ☺

Common misconceptions about Trading

- Higher timeframes are easier to trade ☺
- Market are rigged – so, cant make money
- Smart money is really ‘smart’ and they don’t lose.
- Stoploss hunting
- Take blanket 2% risk per trade ☺
- There is only one ‘correct’ way to trade i.e my way of trading
  – all other methods are useless ☺
- Experts make only profits and no losses – based on their SM posts
- There exists a method of trading that gives no loss

Developing a trading system – practical approach

- Learn a concept like price action (different types), technical analysis(indicators) or any other market driven concept

- Understand your availability during mkt hours and choose timeframe wisely

- Start with naked charts and move your way up with indicators(if any)

- No more than 2 indicators in the screen

Developing a trading system – practical approach

- Create rules around the concept (after eyeballing 100s of charts) – clear entry and exit rules (lesser the number of rules, better it is)
- Test it for sample quarters (1 qtr per year is ideal – 10+ years) and see if it has an edge
- More often than not, your rules will reflect your understanding of mkts (Breakout vs pullback)
- Backtest it for larger sample size once sample testing is over with
- Create MM plan and start executing (taking the system live)

What is price action trading ?

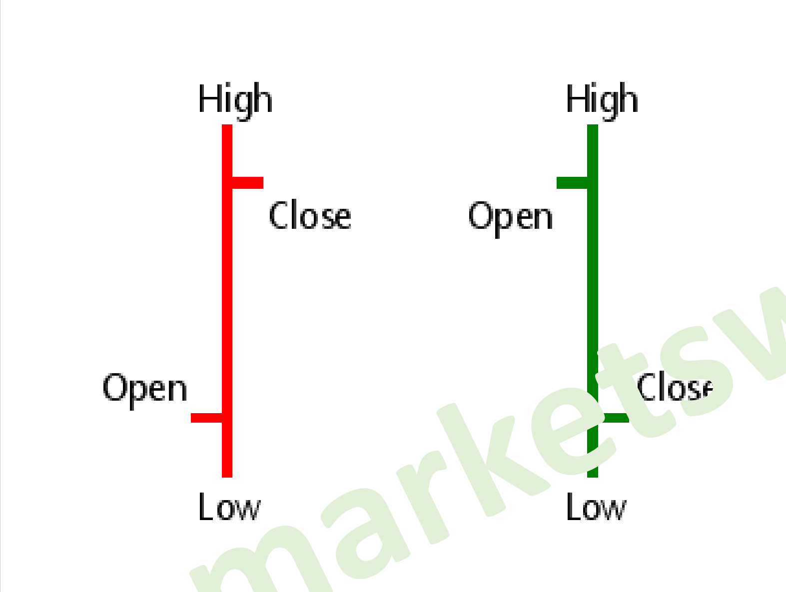
- Price action trading is a form of trading where trader takes trades based on only price movements
- Price action traders don't typically concern themselves with "Why" something happens
- Price action traders strongly believe that true info comes from price itself
- No need for lagging indicators and other fancy stuff
- Various types:
  - candlestick patterns, Moving averages, floor pivots, structural pivots

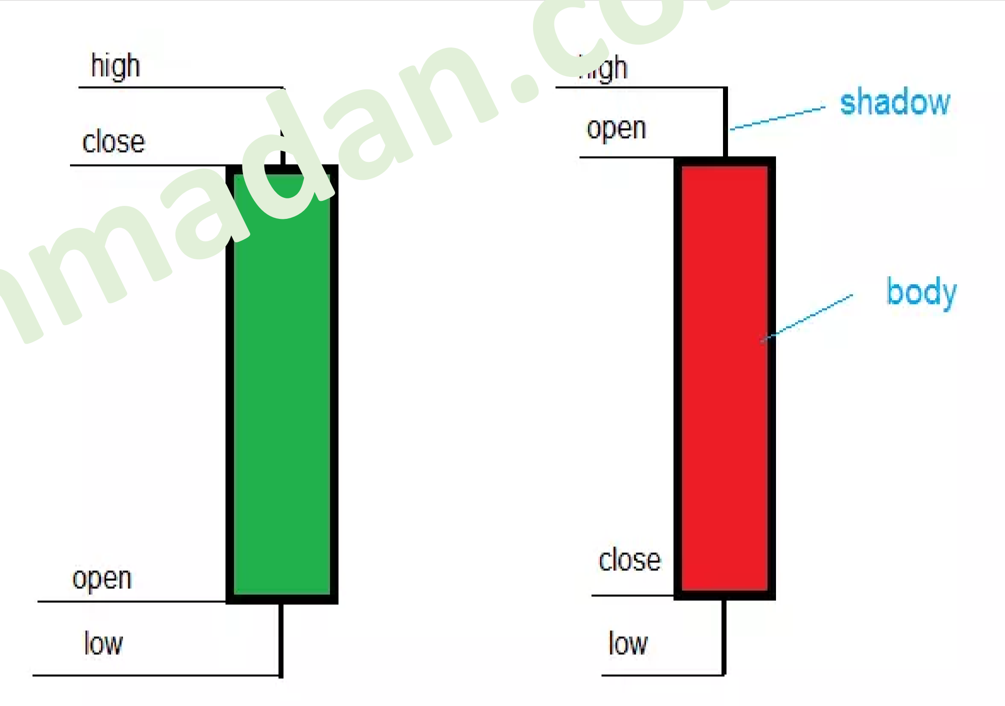
  (Pics: Floorpivots, CS Patterns, MACrossover)

Why price action trading ?

- Price action analysis is a time tested strategy – used for decades…closest to pit trading
- As there are no indicators, there is no 'paralysis of analysis' – Pics "Justbars" & "Indicator"
- Many think PA trading = discretionary ☺
- No need for fancy software (can be backtested with simple OHLC/candlestick chart)
- Can be applied across different asset classes – stocks, options and futures
- It has been proven that if the chart is free of clutter, it reduces cognitive stress of traders.

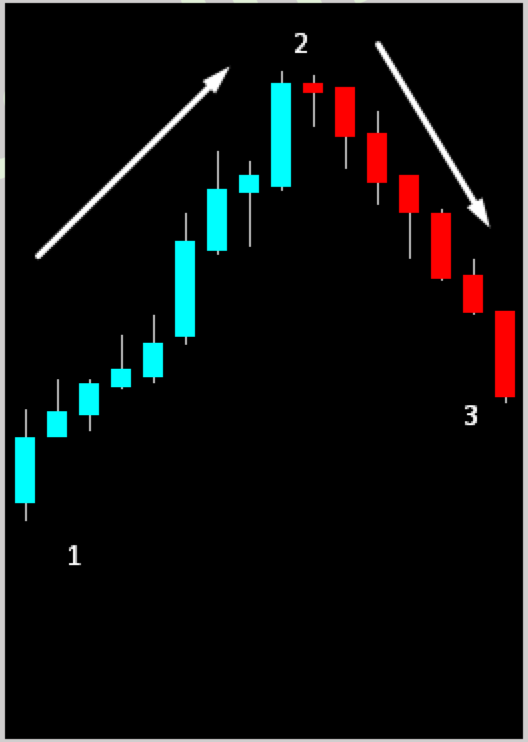
OHLC and Candle sticks





Market rallies and declines

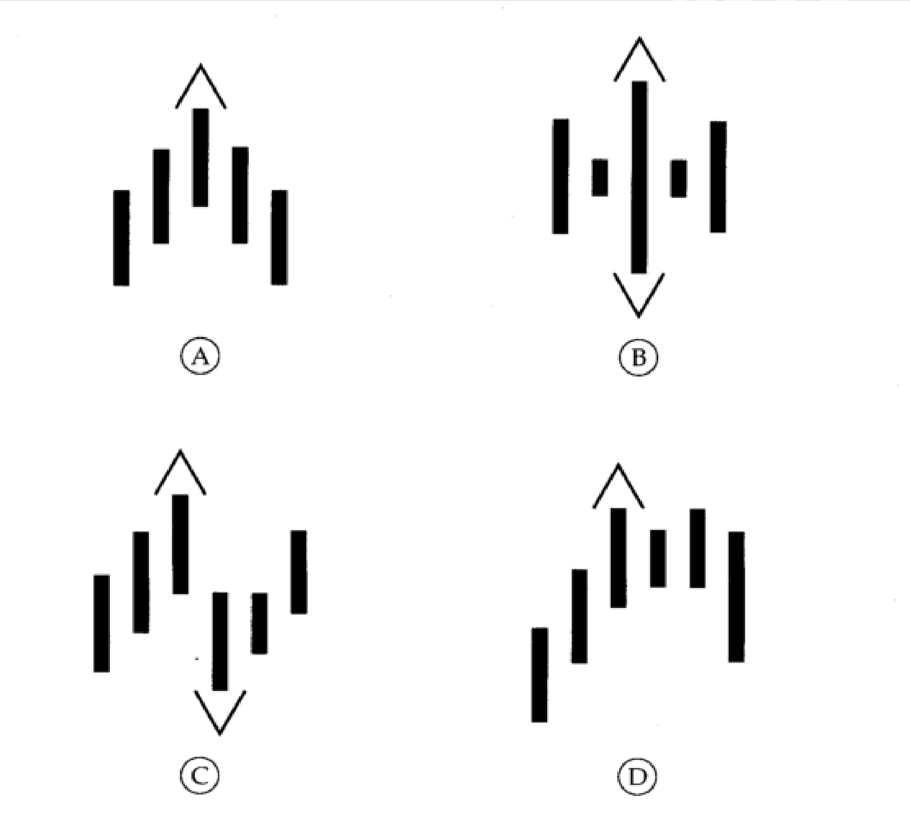
- Rally is a sequence of bars making higher high/higher lows
- Decline is a sequence of bars making lower high/lower lows



Structural Pivots Method (SPM)

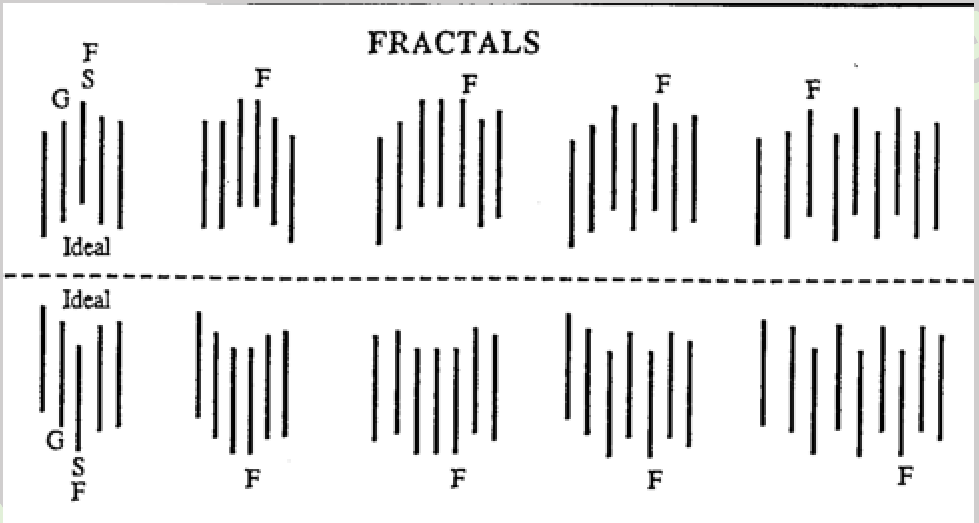
Structural Pivots Method (SPM) - Story

- Structural pivots were originally called as ‘fractals’ by Bill Williams in his book ‘Trading Chaos’ in 1990’s
- Bill Williams mentioned a lot about Elliott wave and his fractal patterns has ‘five consecutive’ bars.



Structural Pivots Method (SPM) - Story

- He also created many rules for fractals that it became almost impossible to identify inflection (turning) points of a trend even in hindsight.



- As there were many rules to mark fractals, it was practically impossible to trade that concept in a mechanical way.
- Many variations started to emerge from 1995's and people used lot of innovation in marking fractals.

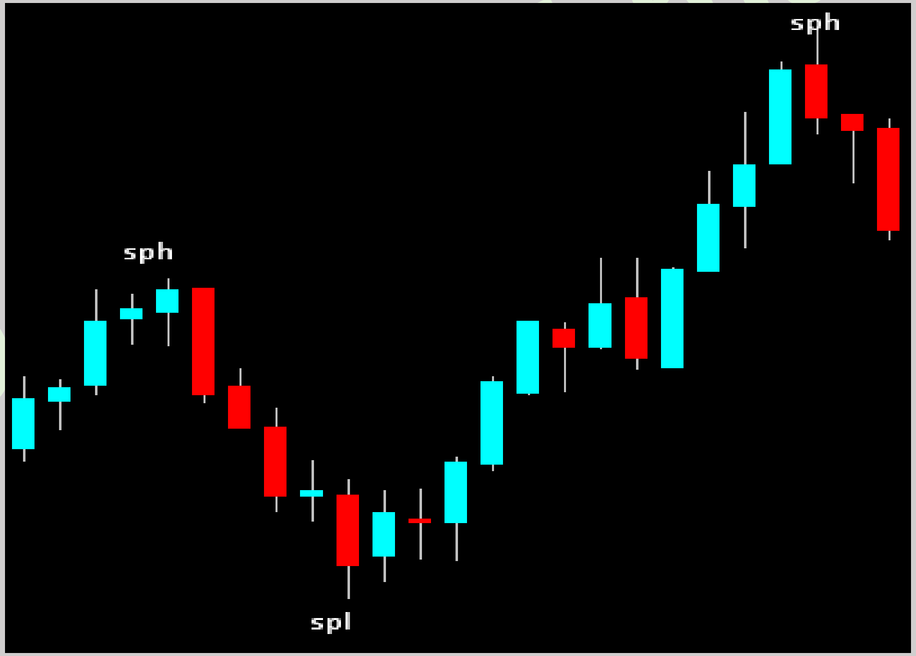
Structural Pivots Method (SPM) - Story

- More rules and complications = fertile ground for thinking in a discretionary way.
- Numerous local yahoo groups started discussing fractals in later 90's & people interpreted it differently
- Trader from Atlanta taught me SP in 2007 and then I modified it based on my understanding about the markets.

Structural Pivots Method (SPM) - Small Pivots

- In a rally, when we get 2 lower closes and lower lows, we get to mark Small Pivot High (sph)

- In a decline, when we get 2 higher closes and higher highs, we get to mark Small Pivot Low (spl)



Structural Pivots Method (SPM) - Small Pivots

- Concept of anchor/reference bar
- Importance of creating rules objectively to mark the pivots
- If rules are adhered, all will mark the same pivots

Small Pivots – Rules for marking

Small Pivot High	Small Pivot Low	Common Rules
• To mark sph, we need two lower lows and two lower closes compared to anchor bar • SPH is the highest point in between 2 SPLs • SPH alternates with SPL	• To mark spl, we need two higher highs and two higher closes compared to the anchor bar • SPL is the lowest point between 2 SPHs • SPL and SPH alternate with each other, SPL cannot follow another SPL	• Bar 1 & Bar 2 for marking small pivots does not have to be consecutive bars **UNTIL WE GET TO MARK THE SMALL PIVOT (HIGH OR LOW)** • **Anchor Bar** or a reference bar is taken as a starting point to compare high/lows • Only Bar2 of prev marked pivot can 'start' acting as the anchor bar to mark the next pivot • Recently marked small pivot is temporary. It becomes permanent only after marking the subsequent small pivot.

Structural Pivots Method (SPM) - **Small Pivots**

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Structural Pivots Method (SPM) - Small Pivots

- Higher high and higher low SPs – SUT
- Lower high and lower lows SPs - SDT

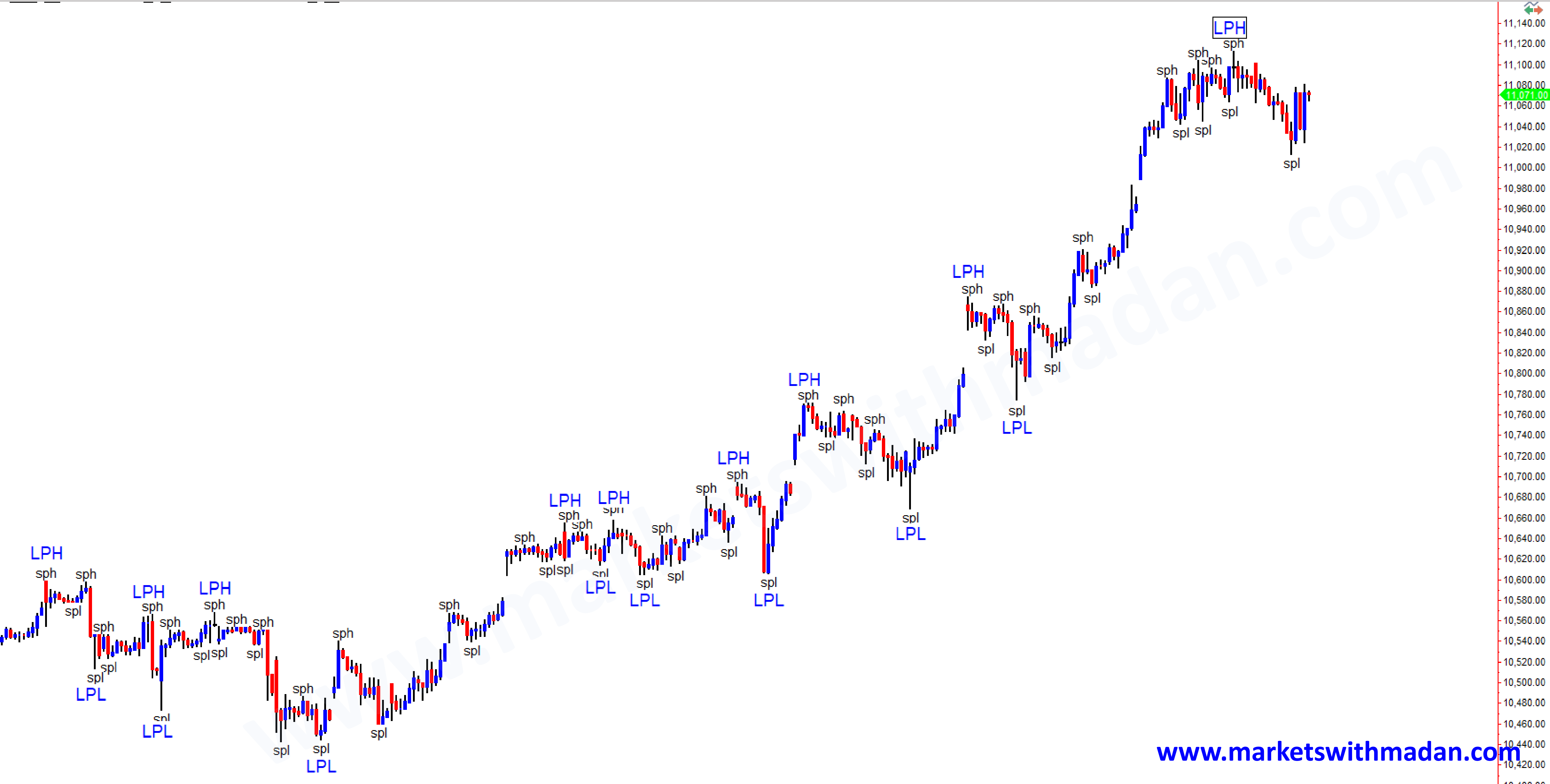
Structural Pivots Method (SPM) - **Large Pivots**

- **Large pivots have specific set of rules to mark.**
- **They can be used to define larger trends**
- **LPs can be used for pure trend following (ride the trend till it bends)**

SPM Large Pivots – Rules for marking

- To mark LPH, we need to break the previously marked spl(temp spl break is enough)
- To mark LPL, we need to break the previously marked sph(temp sph break is enough)
- LPH and LPL alternates...
- To mark LPH, we go back to see all the sphs (that were marked after the last LPL – including highs) and mark the highest sph as LPH
- To mark LPL, we go back to see all the spls (that were marked after the last LPH – including lows) and mark the lowest spl as LPL
- Once marked, Large pivots are permanent (no temp pivot concept like spl/sph)

Structural Pivots Method (SPM) - **Large Pivots**



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Structural Pivots Method (SPM) - Large Pivots

- Higher high and higher low LPs – LUT
- Lower high and lower low LPs – LDT
- Pictures of stocks with Structural pivots marked – weekly and daily

Structural Pivots Method (SPM) - **Positional trading <u>possible</u> entry rules**

Long Entry rules for 30 minutes chart

1. **Entry – Long over LPH or Long on sph above LPH or long on any sph above LPL**
2. **Re-entry long – Long above the recent high after getting stopped out**
3. **Re-entry long – Long above new sph above LPH**
4. **Re-entry long – again break of LPH**
5. **Gap up – If not in trade and gap is above LPH or below LPL line; then enter on break of high of first 30 minute bar for long and break of low of first bar for short**
6. **Vice versa for shorts**

Structural Pivots Method (SPM) - **Positional trading possible exit rules**

Long Entry exit rules - 30 minute chart

1. **Stoploss = last spl. If it is too far then 0.25 to 0.4% of Nifty value**
2. **Early exit idea – Exit at the break of low of the entry bar (or) preceding bar of the entry bar. One can also exit if a bar that closes below the entry point and that bar low (for longs)**
3. **Trailing SL = successive higher spls or LPLs**
4. **Gapdown – If in trade and gap against our trade, then exit on break of low of first 30 minute bar**

Structural Pivots Method (SPM) - **Intraday trading possible entry rules**

Long Entry rules for 5 minutes chart

1. **Entry – Long over LPH**
2. **Long on sph above LPH or long on any sph above LPL**
3. **Re-entry long – Long above the recent high after getting stopped out**
4. **Re-entry long – Long above new sph above LPH**
5. **Re-entry long – again break of LPH**
6. **Gap situation – If not in trade and gap is above LPH or below LPL line; then enter on break of high of first 5 minute bar for long and break of low of first bar for short**
7. **Market gaps down below LPL and creates a sph – go long above sph**
8. **Vice versa for shorts**
9. **One special condition for shorts – Market gaps above LPH and creates a red 5 minute bar..Go short below that bar low..no need to wait for spl creation.**

Structural Pivots Method (SPM) - **Intraday trading possible exit rules**

Long exit rules - 5 minutes chart

1. **Stoploss = last spl or 0.3% of NF value**

2. **Trailing SL = successive higher spls.**

3. **Trailing SL = LPLs**

4. **Aggressively start trailing after market gives us 0.5% of NF value as profits – as in intra, time is against us**

5. **Aggressive trailing = previous bar low or low of the bar that hits the 0.5% of NF value**

Intraday options account – the story so far

1. Traders typically start with less capital – so compounding (or) periodic addition of capital needed
2. Have seen few non-indian traders showing compounding live
3. Never seen anybody doing it in Indian market

   a) One needs to trade the markets to do this activity – paper traders and analysts cant do ☺

   b) Trader needs to be successful consistently atleast for a decade. If not, figuring out how to be profitable will eat away all resources – forget about compounding the account
4. Account is around 24.6L (as of April 30th) at the end of 14 months. Started directional option selling(monthly) from 15L. Trading reduced lot size due to increased intraday margin.
5. Limit the number of trades to 1 per day (average) to avoid burnout

Intraday options account – the story so far

6. One can use filters like

   a) taking trades outside of previous range only

   b) Trading only when mkt breaks 1st hour range

   c) Taking long trades only above ema like 21 – vice versa for shorts

   All the above are ideas one can use to bring down the trade number to 1 trade a day – very important for intraday.

7. If you are struggling as a trader, try this idea – double your SL and reduce your position size by half ☺

7. Daytrading is not easy as everybody thinks (☺) - our margin of error sharply comes down. One should be very good in execution and very fast in acting on reversals.

8. If you are not profitable in positional/swing trading for atleast 3 years, please don't come to intraday trading – probability of ruining capital is very high

Why backtest a strategy ?

- Test driving a car

- If past results are bad, there will be no conviction in taking the real trades

How to efficiently backtest a strategy ?

1. Software
2. Data – purity and month-month contract value - very important for positional system backtesting
3. Definite set of rules for entry and exit
4. If scaling in/scaling out, it is a separate system altogether
5. Bar-by-bar replay
6. Taking care of rollovers (month to month data is needed)

Evaluating backtesting results

1. Average points per year

1. Total trades

2. Win %

3. Risk:Reward ratio (R:R)

4. Win% + RR – *should be evaluated together*

5. Max drawdown

6. Max consecutive losing trades

7. Expectancy of a system = (Avg winning pts x Win %age)-(Avg losing pts x Losing %age)

8. Risk of Ruin

9. Calmar ratio

10. Importance of Max drawdown and Calmar ratio (for compounding)

Probability of losing streak

Losing streaks – 5000 trades

Win%	Possible losing streak
30	30
35	25
40	21
45	18
50	16
60	12
70	9
80	7
90	5

To be successful, we need to accept that losing streaks will occur.


Q & A

Money management – why and how?

- Risk is the only thing we can control
- Many successful traders attribute their major portion of success to MM
- MM is simply a numbers game and needs a system with +ve edge to be applied upon.
- All we need is a system with +ve expectancy and we can take care of the rest through MM
- The only reason a trader should not apply MM from the 1st trade is if he expects to lose. If that is the case, why trade in the 1st place ☺ ?

Money management – Lots/fixed amount

- ❖ Trader usually fix a random amount needed to trade per lot
- ❖ Method 1 calculation – Amount needed per lot using Max DD (by doubling it) – I use this in my intraday options account in an aggressive manner.
- ❖ Easy to understand MM type

Money management – Fixed percentage risk or Fixed fractional

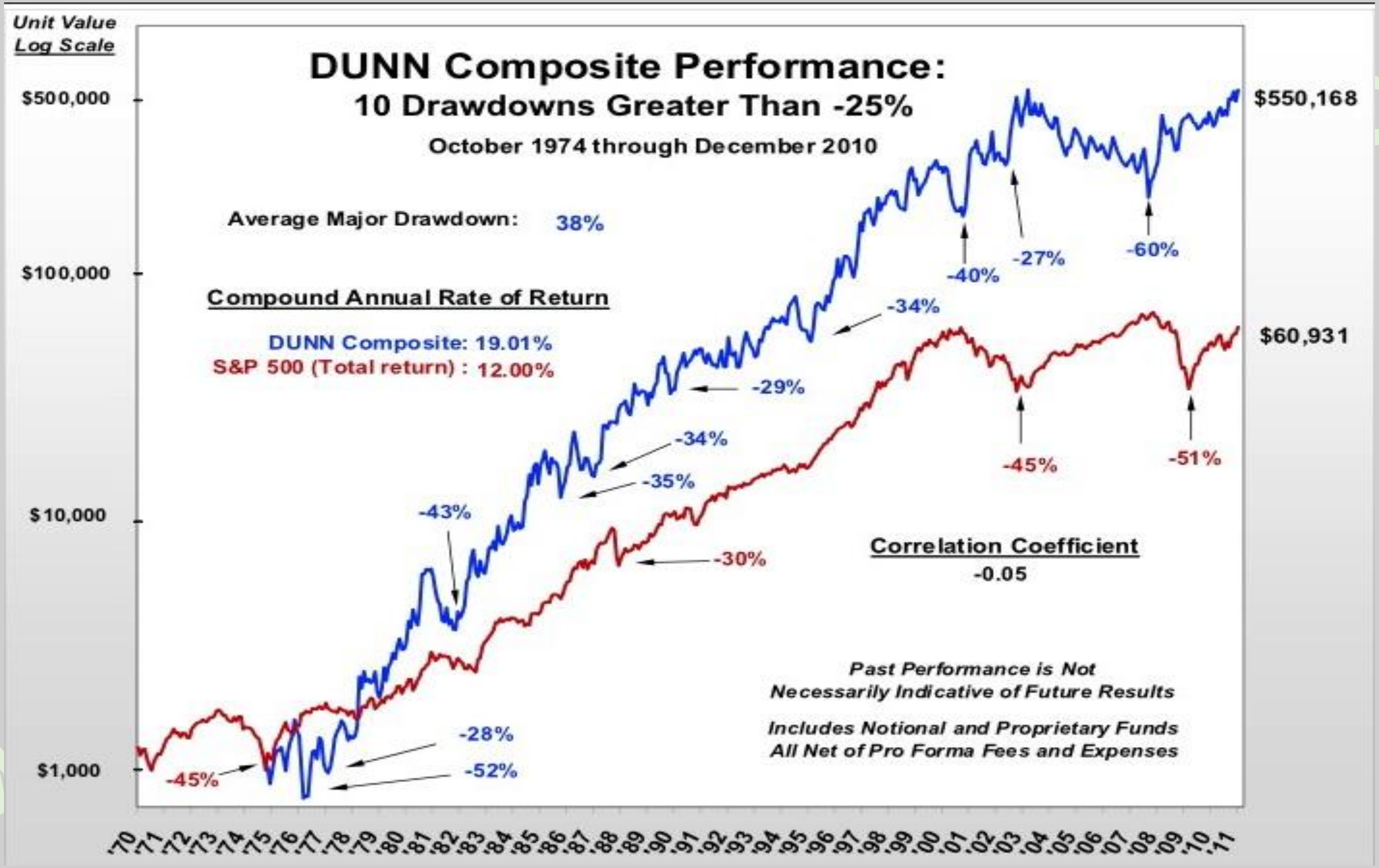
- Trader determines the risk %age he is willing to risk per trade
- Method 2 & 3 calculation – Risk percentage based on numbers of losers in a row and risk of ruin
- Good - Same weightage for all the trades given
- Bad – Stoploss jumping can let the trader lose more than intended.

Money management – Conclusion

Money management plan can be created (logical) only if you have –

1. Mechanical (100% rule based) system to enter/exit markets
2. Backtesting for longer period of time (10+ years or 5000 trades, whichever comes last)
3. Use the routes we discussed to get the optimal amount needed.
4. System with Expectancy of 0.4 vs Expectancy of 0.5 (assume 200 trades/year)

Typical trend follower equity curve



Why trading is more difficult for many?

- No trading plan
- People don’t take responsibility for their results
- Gamblers fallacy
- Undue weightage to current trade outcome
- Need to be right
- Humongous expectations and lack of capital

Psychology – the facts

1) Psychology plays a major role in all areas of our life – in day-to-day activities

2) In trading, it wreaks havoc by

a) Letting the trader focus on only the money part

b) Letting the trader take revenge on the market for his shortcomings

c) Letting the trader fulfill his needs (excitement, recognition) inside the market

d) Letting the trader invoke 'need to be right' thought and therein, turn a small loss to a much bigger one

e) Letting the trader cut the winning trades short as the inner-belief does not let him take larger profits

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Part time vs Full time trading

1) Expectations

2) Trading larger timeframes (at least 15 minutes chart) while in job/other business

3) FT trading is a different game altogether
   – need to make money could be a major hindrance if one is not funded well

4) The fact is
   – trading for a living is far harder (than expected) due to psychological hiccups

Surefire steps to blowing the account

1) Small capital and high expectations

2) Trade randomly with no defined edge

3) Don’t cut your loss, just hope it will come back.

4) Having the thought that ‘I can recharge the account balance if its blown’ ☺

5) You are feeling pressurized to trade. Previous days trading you lost money, so you want to recover the loss

6) Focusing on potential gains and not the potential loss(the only thing that is…)

7) Trading for onions and tomatoes (performance pressure)

Psychology – Final thoughts

1) Why discipline is important to achieve anything in life?
2) Losing weight, exercising, even brushing the teeth every night needs discipline
3) Power of ‘delayed gratification’ vs Instant gratification
4) Exhibiting patience in everyday activities would imbibe the trait hard within

Psychology – Final thoughts (Contd)

5) In order to succeed as a trader you need patience in the following areas:

- waiting for a good trade
- holding on to a good trade
- developing your trading skills
- learning from your mistakes
- recognizing your own trading personality
  -- *scalp, trend trader, countertrend, non-directional?*

6) There are roads which must not be followed, armies which must not be attacked, towns which must not be besieged, positions which must not be contested – "the art of war' by Sun Tzu