THE 7 DEADLY SINS OF TRADING

Common trading mistakes and

how to turn these into strengths

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Introduction

The Trading world is littered with advice on how to trade. Most commonly, novice traders seek information on the idealised setup and the optimal set of indicators; the perfect technical pattern; and the best entry method. However, very rarely is the focus on **"not what to do"** as opposed to what to do. This is a shame as some of the best experiences we gain as Traders is feedback from our mistakes.

As Senior Market Analyst at FP Markets, I am in a very fortunate position to work with an array of different traders. If I could single out one reason that distinguishes the most successful traders from the rest, it would be that the best traders have the ability to learn from their mistakes in the market and build on their strengths. They are able to identify when they are wrong in the market and get out. They have enough screen time and feedback loops from the market that they know what works for them and not what to do.

All traders get it wrong at times and make mistakes. All of them!
The simple truth to me is that most traders will ignore trading advice and rules until they have "found the light" through their own trading experiences. Most traders will repeat a mistake many times before they finally get the message.

> ***"It is literally true that millions come easier to a trader after he knows how to trade, than hundreds did in the days of his ignorance."***
>
> *– Jess Livermore*

Thus, I am under no illusions that my words may take time to sink in, but I do hope that it will speed up the path to success and limit the number of times trades make such mistakes! The aim of this Education piece is to outline some key mistakes that Traders make. More importantly, I want to expand upon potential solutions for these common pitfalls.

1

Letting Lossesrun, Cutting Winners prematurely

"I did precisely the wrong thing. The cotton showed me a loss and I kept it. The wheat showed me a profit and I sold it out. Of all the speculative blunders there are few greater than trying to average a losing game. Always sell what shows you a loss and keep what shows you a profit."

Jesse Livermore

How many times have you heard the axiom "cut your losses short". Yet it is amazing how many traders fail to do this. If I could highlight the biggest shortfall of traders it is this principle.

The best Traders I work with have a win ratio of between 45 to 55 per cent. Think about that for a minute. This is the win ratio of the most successful traders who trade day in and day out. Their success is based on position management, and their ability to take quick losses and ride winners. You are going to be wrong a lot as a Trader - that is the nature of dealing in uncertainty. What really matters is how much you make when you are right, and how much money you lose when you are wrong.

Solutions

- Traders should always plan their trades in advance with a clear stop loss. This stop loss should reflect where the underlying trade idea is wrong. For instance, If it is a breakout setup and the stock falls back below the breakout level, get out. If it is a support trade and support drops, get out. Always get out when the premise for the trade is invalidated.
- Set stops at the same time as the initial entry signal. Use contingent orders - that is what they are there for.
- If the trade fails to follow through strongly from the initial entry, think about getting out of some of the position. The best trades move higher from the outset.
- Exit trades if developing price action or patterns are contrary to the trade idea. As Jack Schwager notes, traders should ask "if I had to have a position in this market, which way would it be?" If the answer is not the position you hold, get out!

EXitinG tRADES

- Scale out of profitable positions into the target. Stocks have a habit of overextending on the upside and beyond what we deem possible. By scaling out of winning trades, one is able to lock in some profits whilst riding the underlying trend and price action. Wait for the stock to confirm your target with clear exhaustion.
- Be opportunistic with winning trades. Most educators are advocates of trailing stops. However, to me this is saying to the market come and get me. Use euphoria to lock in winning trades. When price action clearly shows signs of exhaustion, looks for bounces to liquidate the remaining core position.

2

Overtrading

There are so many trading opportunities out there across different timeframes and markets that it is often difficult to know where to look. The novice trader will jump around from one trade to the next without a clear understanding of the timeframe one is trading. Furthermore, they try to become a "jack of all trades" without spending enough time mastering just one particular setup or style of trading.

The pathway to success in the markets is finding a particular method that suits one's own personality and timeframe - then sticking to it.

Solutions

- Develop a plan of what trading you would like to do that fits your personality and situation. If you like quick action and want to be highly involved in the market, day trading and scalping could be the way to go. If you like doing research or the idea of trading on major technical levels/pattern, you might want to do less trades and focus on long term styles of trading.
- Focus on one particular pattern or setup first and master it. Practice and repetition are key to internalise this setup.
- Whilst in the learning and development phase, use demo accounts to test your trading ideas and skills.
- With these experiences, define and write down your methodology and trading plan

3

Trying to pick tops and bottoms

The trend is your friend. Once again, this is a often repeated axiom but it is amazing how often traders fail to heed this underlying principle. In particular,
I see clients try to pick tops time and time again.
By trading with the trend, you are trading with the momentum and the prevailing bias. You put the odds in your favour. When a firm trend is established, the theme has a tendency to self perpetuate.

Of course at times these trends can exhaust. However, in my experience this is a process rather than just a sudden unwind. There are many signals along the way.

Solutions

- If looking for a reversal out of resistance, WAIT for price action and patterns to say the timing is right. This can include bearish candle reversals, spikes, and failed breakout patterns. You are better to be late once the market has tipped its hand rather than going early.
- If looking for a reversal out of support, WAIT for price action and patterns to say the timing is right. This can include bullish hammer candles, bullish engulfing candles, and breakouts from base patterns.
- The easy time to be short is when the market is actually going down. Wait for the market to tip its hand and show a series of lower lows and higher lows on the Daily charts.

4

Prediction rather than following the market

There are many methods out there that attempt to "predict" the markets next move. The usual suspects include Elliott Wave and Gann Analysis. This is not to say that these methods do not work- indeed I use many tenets of Elliott Wave in my own analysis to define support and resistance.
However, it is important to understand that trying to "predict" the market is almost impossible and leads to an underlying bias. Such biases takes you off what really matters- price action.

Having spent many years in the markets, I have come to realise that prediction is nigh on impossible. I do believe we have become increasingly prone to shocks and surprising events which have a major impact on the markets. With increasing government intervention and volatility in the markets, how can one possibly predict or forecast with any kind of certainty in this environment? Instead what I try to do is identify key risk/reward areas and heed the underlying price action at such junctures.

The best traders are able to follow what the market is actually doing NOW. Remember we are traders and not fund managers.

Solutions

- Use a set of confirmation rules or signals to ensure timing is right now. For instance, if forecasting a "timing window", wait for clear signs that the stock is actually turning in the direction of your analysis. Focus on Daily confirmation as opposed to tick charts.
- Try to focus on one target at a time rather than "big picture" targets and predictions. Gauge the price action as the market evolves at each minor target along the way. Be conservative and realistic in your targets, especially in this age of volatility in either direction.
- If using Elliott Wave, try not to fit every move into one overarching count. This leads to a bias. Understand corrective versus impulsive patterns and look for strategies to trade them.

5

Lack of flexibility and Holding a bias

"A prudent speculator never argues with the tape. Markets are never wrong, opinions often are."

– Jess Livermore

I see it time and time again. Traders are 100% long in a falling and down trending market and they just keep on buying. There are some who are 100% short in a up trending market and they just keep on shorting, trying to identify new reasons why the top is near. All the
time these traders are hoping and trying to find new evidence to justify their position. This is the sure path to failure. As Einstein once wrote, ***"Repeating the same exercise and expecting different results is the pathway to insanity".***

Traders have to be flexible and heed what the market is actually doing. Once again, it is ok to be wrong. However, being wrong and staying wrong is illogical. The best traders are able to flips positions based on the underlying price action.

Solutions

- Never be too hasty to get back into a losing trade. Wait for clear confirmation that your initial trade idea was right before getting back in
- Examine your losing trades. Is there a clear skew in long versus short positions? Can you identify a bias in your trades?
  If so, re-evaluate your methods.
- Hedge and Diversification. Rather than being positioned 100% in one direction, look to balance the portfolio.
- Understand the importance of importance of failed patterns. Patterns such as bull traps, bear traps and failed breakouts imply the crowd is positioned one way. The subsequent reversal can be violent. These are the exact moments to be flexible and not hold rigid views.

6

Analysis Paralysis

The pathway to finding a method is certainly not easy. There are many trials and experiments along the way. The temptation is to look for a particular indicator or a set of optimised moving averages and backtest these over past data. The problem with this is that the market is constantly changing! This is also classic curve fitting.

No doubt many indicators do work at certain times. However, novice traders often pile many of these indicators onto their screens. What this does is complicate the picture and hinder decision making. Traders become so caught up with the different messages that they forget the most important thing – what price is actually doing.

Trend following indicators work in trending markets. Range bound indicators work in choppy markets. However, the problem is that every trend eventually fades into a trading range, and periods of consolidation or choppiness are the prelude to strong breakouts and trends. It is extremely difficult to know in advance when the market environment is going to change from one condition to another. Thus, having all these indicators leads to confusing signals that impede effective decision making.

Solutions

- KISS – keep it simple!
- Test methods and indicators on a simulator or demo. This will enable the trader to come to terms with the advantages and disadvantages of various indicators in the trial phase.
- Research the strengths and weaknesses of Mechanical trading systems. The best book for this is Jack Scwhager's, ***"Schwager on Futures: Technical Analysis***

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Lack of preparation, self evaluation and practice

I see many parallels between trading and elite sports. They are both performance disciplines. There is a huge amount of science, training and critical evaluation that goes into professional sport to achieve true excellence. Yet how many traders approach trading in a similar manner?

Most novice traders will run a few scans pre market, turn on their screens and then shut it all down come the market close. They are not spending enough time preparing for the day ahead. They are not spending enough time critically reviewing their trading - both what worked for them and what didn't work for them. Like any professional endeavour, it takes time to build knowledge and the required skills. Yet many traders do not put in the hard yards to get to this level of expertise.

Solutions

- Practice via simulated trading
- Keep detailed trading records and notes
- Critically evaluate performance, win/loss ratio, trading setups
- Put the hours in after the close
- Run detailed scans re market
- Go through the routines - wake up that extra hour early, study offshore price action, read the headlines

Conclusion

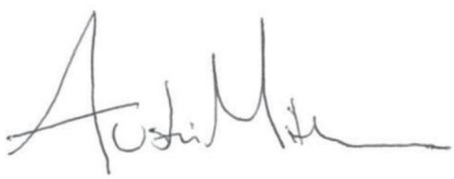
Trading is not easy. The high failure rate is testament to that. The reality is that traders just need to survive the learning curve to get an understanding of what works for them and how to approach the market. Along the way you will make mistakes which is inevitable.

You will also be wrong. It is rather sobering BUT this is all part of the learning curve. The successful and improved traders I work with show that you can be successful in the market if you just learn from your mistakes. I hope this article has identified some common traps and makes you better prepared in your own journey. Use your mistakes in your own self advancement to trading success.

Thanks, Austin

Austin Mitchum,

Senior Market Analyst



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