**HOW TO AVOID BLOWING UP IN THE STOCK MARKET**

The person you most have to fear in trading is yourself. You can be your own worst enemy

when trading if you don’t have dedication and a willingness to learn. Nothing can be as

expensive as learning to play the stock market when you don’t know what you are doing.

Here are some of the mistakes that I made when I first started and some of the common reasons why beginner traders usually lose at the first attempt. Try and avoid them at all costs.

**Never trade blind**

This first one seems like a no-brainer but you would be surprised at the number of people who

try to play the stock market each year without having the sense to learn a thing about it.

When I first started, I thought the best strategy would be to just jump in and learn by doing. But

with investing this is a flawed strategy. The stock market can be a harsh mistress and punishes

those without a good system. There are few professions that are as expensive to learn as

trading, so before you begin, equip yourself with the best tools, the best knowledge and the

best techniques.

Similarly, never blindly follow advice or a tip from someone else. Your neighbor may truly

believe that Texas Instruments is about to triple next week but if you haven’t done your own

research it’s unlikely you have the confidence to sit with the trade once you have put it on.

**Never trade by emotion**

We have all experienced the emotions of greed, fear or hope. These emotions rule in the stock

market even today. A piece of advice – when it comes to playing markets, the best time to buy

is when people are fearful and to sell when others are greedy. It is a good, timeless piece of

advice, because it goes against human nature and works more times than not.

Indeed, if you often change your position as soon as you have put it on, or sometimes do not

have the courage to put on a position (instead, waiting until it is too late), then you are

probably trading out of fear. Systems can be an excellent way of combating these problems.

When I first started, I only had to put on a small position before I began to feel agitated and

doubtful of my choices. So much so, that today I use a much more systematic approach, which

is automated by up to 80%.

Similarly, if you often add to winning positions hoping to win even more, or jump in the market

at any opportunity, you are probably trading with greed.

Don’t worry, it’s only human and we have all been there. Do your best to conquer these

emotions and you can be well on your way to trading profitably.

**Never invest all your capital into one thing**

This one seems like common sense too but is something I was guilty of back in the beginning.

If the last few years have taught us anything, it’s that even so-called safe investments, like

savings accounts, are not always completely secure. If that can be said about a bank, think

about how unsafe it is to put all your money on a short-term trade.

Investments should be spread over a portfolio of different securities, so if one fails you do not

lose all your money. Diversification could include bonds, currencies, precious metals, short

positions or simply different stocks. If you are into shorter-term trading or investing, a good

rule of thumb is to invest less than 2% per investment with an exposure of no more than 25% of

your capital.

Also, you should never trade with money you can’t afford to lose. You are likely to make all

sorts of bad decisions and put your credit rating under threat.

**Never overtrade**

Investing all your money into one thing can also be called overtrading. It’s risking too much

capital on any one position and, quite simply, it means that one bad trade can result in losses

big enough to wipe out an entire account.

The second definition of overtrading is jumping in and out of the market too many times in an

attempt to catch lots of short-term moves or because you are undecided.

The problem is that the commissions for each trade significantly eat into profits and destroy

your chances. Trading is not a zero sum game, because each time you trade you are paying the

spread to your broker. If you make too many trades, you are effectively gambling and the

commissions will destroy you.

Again, I was guilty of this problem at the beginning, largely because I didn’t really know what

I was doing. Once you develop a strategy that you feel confident with, the problems of

overtrading tend to disappear.

**Never follow tips**

While it can be good practice to listen to what the experts are saying about markets it is

generally not such a good idea to trade like them.

The problem with following someone else’s advice is that when the trade turns sour you most

likely won’t have the confidence to stay in the trade. Successful traders rely on their own

research and strategies that are aligned with their own risk appetite. That way, they always

hold themselves responsible for taking trades and this fosters a much healthier attitude towards

trading.

Another reason for not listening to someone else’s trading picks is that they rarely give you all

the information. The tipster may well have hedged his bet with some other trade, or they may

have a take-profit target that they haven’t disclosed.

Even worse, they may have a conflict of interest, such as a broker who wants you to buy a

certain stock so that they receive commission for the sale.

In general, brokers are salesmen and are not the best people to listen to when making trading

calls. If they were any good at trading they would probably be running hedge funds and not

working as brokers.

**Never place stops randomly**

Markets can go in any direction, so without stops the possible downside to your investment can

be limitless. That’s why many successful traders use stops in the market to limit the possible

downside to their investments. Many traders find that stops need to be kept super tight in order

to manage risk effectively.

However, other traders find that stops can destroy their strategies if they are placed too close

to the action. They therefore place their stops far away and use other rationale to exit their

trades.

The best solution is to test your strategy to find out where the best place to put your stops is

and to never enter them into markets randomly.

**Never fight the trend**

All good traders know the best way to trade in markets is to follow trends. Going against the

tide can sometimes offer big rewards but it requires patience and, more often than not, it is a

losing strategy in the long run. Indeed, if you look through history, most successful traders have

been those who have gone with the trend. The best advice is therefore to ride winners and cut

losers quickly.

Traders who try to go against the trend usually end up running out of money pretty quickly.

Victor Niederhoffer is one example of a great trader who went against the trend, but even

Niederhoffer ultimately experienced more than one period of bankruptcy in his career.

**Never trade without a plan**

It can take a bit more work but to trade the markets successfully it is vitally important to have a

plan of action in place, so you know exactly what to do when things go wrong (or right). Each

trade should have at the very least an entry and exit target, a stop loss point and a good reason

for making the trade in the first place.

It’s important to look at the current situation and imagine what would happen if markets were

to change. What would happen to your investment if war broke out or the Fed raised interest

rates? What would happen if oil went to $150 a barrel? Understand what could happen to your

investments under different scenarios and plan what you would do when those scenarios play

out.

**Never trade the unknown**

Many traders and investors are successful, not because they have some innate ability to time

markets, but because they specialize in one or two areas and learn them inside and out. Indeed,

there is no shame in concentrating on your area of interest, you don’t always need to be able to

trade every market under the sun.

Be it oil, gas, real estate, gold miners or biotechs, focusing on one or two areas is one of the

best ways to prosper. Concentrate on what you know and you can have an edge over 99% of

the rest of the markets, which in reality is all you need.

**Never ignore money management**

Money management is the key to successful investing. Period. In fact, excellent money

management can be the difference between a profitable and a losing strategy.

I have already stated earlier in this book, as a rule of thumb, you should aim to commit only 1-

2% of capital on any one trade.

**Never gamble**

Trading is not the same as playing roulette or blackjack. It is possible to make big money but

only if you take a professional and disciplined approach at all times.

That means treating it as a full-time job and never chasing profits, never overtrading or risking

it all on one trade. Trading on the basis of a whim or an emotion is akin to gambling and only

ends up losing you money in the long run. Always remember, trading is not strictly a zero sum

game – due to the commissions you pay every time you trade. So make sure you don’t fall into

the trap of trading for fun. It’s a good idea to set up a separate bank account for your trading

ventures and treat it as a business.

**Study your performance**

It seems like a no-brainer but the majority of traders are too lazy to do this one. Simply, if you

want to improve your trading, it is essential to study your performance. Keep track of your

performance objectively by keeping a diary or spreadsheet of every trade you make, including

such things as stop loss levels and charts if necessary.

If all that sounds like too much hard work, contact your broker and have them send over your

monthly statements for analysis. Once you have your ‘real’ stats in front of you, you can then

set about seeing which areas you do well in and which ones need work.

Maybe you set your stops too tight, or maybe you become too fearful ahead of news releases.

Work on those weaknesses and you can come out ahead of the traders out there who fail to

learn from their mistakes.

**Back-test/paper trade**

One possible way to succeed in trading is to try and automate as much of the trading process as

you can. That way, you automatically rid yourself of having to deal with the common pitfalls of

emotional-based trading, such as fear or greed.

Furthermore, if you are able to come up with a strategy with fixed rules and objective goals,

you can back-test the idea on historical data and see what would have happened if you had put

the system into action. This way, you can test hundreds of different trading ideas without

having to lose a penny. Similarly, it is essential to trade your strategy on paper first, before you

put any real money at stake. If you can’t make money paper trading, then you certainly won’t be

able to succeed when it’s real money.

**Have enough capital**

Too many traders make the mistake of entering markets undercapitalized, which puts them at a

disadvantage at the very start. Due to the volatility and inherent risk involved in trading, it is

important to trade small, especially when you are just getting started and that means having an

account big enough for you to do so.

Most traders recommend putting only 1-2% of trading capital at risk on any one trade. It is

sound advice, since there are always opportunities and if you trade conservatively enough,

even if you lose money, you still live to fight another day.

**Choose your broker wisely**

There are lots of brokers out there and some are better than others. It is, therefore, imperative

to seek out a broker that is honest, reliable and one that best suits your needs. If you are a

scalper, you may need an electronic communications network (ECN) broker with ultra-tight

spreads. Or, if the spread does not affect your margins as much, you may want to go for a

broker that excels in other areas such as in back-testing or MetaTrader compatibility. Most

brokers provide demos now, so you can try out their services for free.

**Learn all you can**

It stands to reason that the world’s wealthiest traders did not get there through luck alone. They

got there by learning and studying the craft over many years and they have also studied

themselves.

So always do your homework; read the best books, the best blogs and try as many things as you

can to improve yourself and your trading skill.

Learn about fundamentals, interest rate differentials, the world economies, technical

indicators, trading systems, price action and, most importantly, learn about sound money

management. The cost of successful trading is not just the financial capital you put at risk but

the time and effort that goes into perfecting the art.

**Don’t lose heart**

Although it is painful and you should do everything you can to avoid it, if you do happen to

blow your account on your first attempt, consider it as an education and do not beat yourself up

over it. Many of the best traders in the world have blown up several times in their careers so

don’t lose heart. Take a look through the book, Market Wizards by Jack Schwager, and you

realize that one or two blow-ups is actually the norm, rather than the exception for most

traders. The most important thing is to learn from the process and come out as a better trader.

It’s much better to blow your account early on in your trading career than later on when you are

managing millions of dollars.