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Make Discipline a Habit

Autochartist Trading Tips

VOL. 1

VOLUME 1 - Make Discipline a Habit

DISCIPLINE IS THE KEY

> Discipline is the refining fire by which talent becomes ability.
>
> *Roy L. Smith*

When it comes to trading success, discipline is the key. Discipline will help to put more money in your wallet and take less money out. Regardless of the system you are using, the truth is, discipline will lead to increased profits.

To become a successful trader you must distinguish yourself from other traders. This means putting in more time researching and analyzing the markets. It also means trying to create an edge or advantage over the other traders whose soul mission is to take your money.

For years, traders have been charting the markets by hand, but with the advent of technology, one now has the ability to use software to crunch the data to either make your analysis easier or automatically generate trading signals. When it comes to analyzing the market, a trader's workload has been greatly reduced because a computer program can now produce dozens of directional and sentiment indicators as well as trading set-ups.

The advent of technology may mean greater access to technical signals, but overall trading statistics have not necessarily improved. This is because no matter how much we computerize the market, the balance remains that trading is 10% mechanical and 90% mental. So while you may have access to more "toys", the game still requires you to develop a mental edge.

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Autochartist is a chart pattern identification tool that scans various markets and instrument types for known chart pattern formations such as triangles, wedges, and channels. It also provides market statistics such as the expected price range for various intraday time periods. Finally, while Autochartist can find the simplest chart patterns, it is also programmed to identify more complex patterns such as Fibonacci retracements, extensions, ABCD, Gartley and butterfly patterns throughout the trading sessions.

In order to use effectively the plethora of data generated by the Autochartist chart pattern identification program, one must become skilled at identifying the best chart patterns suitable for one's trading style and investment resources. In order to develop this skill, one must learn how to filter and analyze the information that is being produced.

What will separate you from the others that use the program will be your ability to identify quickly and frequently possible trading opportunities that you may be able to exploit to your advantage while at the same time protecting yourself from loss. The more disciplined you are at analyzing and researching, the faster you are likely to learn the skill set necessary to become a capable trader.

So while programs like Autochartist can help you with the 10% mechanical side of the trading equation, you still must practice discipline to develop the psychological side of trading which makes up the other 90% of the equation.

PRACTICE DISCIPLINE 100% OF THE TIME AND THE MARKET WILL REWARD YOU

> Discipline is the bridge between goals and accomplishment.
>
> *Jim Rohn*

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The markets have proven time after time that there are no short-cuts to success. When you commit to trading the markets you must practice discipline 100% of the time. It has been proven that there is a direct link between trading in a disciplined manner all of the time and the amount of success one has in the market. The markets tend to be forgiving to those who follow a plan all of the time, but very unforgiving if you deviate from your original plan.

As mentioned on an earlier page, Autochartist is a chart pattern identification tool that scans various markets and instrument types for known chart pattern formations such as triangles, wedges, and channels. Like any other tool, it must be used properly to accomplish the task at hand in an effective and efficient manner.

At times people have used power saws to cut a small piece of wood when a hand saw would've been sufficient only to find they have cut too much. This can happen with pattern identification programs also.

PRACTICE DISCIPLINE 100% OF THE TIME AND THE MARKET WILL REWARD YOU

Just like you can pound a nail into a board with the handle of a screwdriver, a task may be accomplished without the proper tools, but in the long-run, using the right tool will accomplish much more in a shorter period of time. Essentially, to be a successful trader you must learn to use your analysis tools properly in order to accomplish your task in a timely and effective manner.

In an earlier paragraph the concept of developing and following a plan was mentioned. The first step when attempting to incorporate Autochartist into your trading plans will be to learn what the software is capable of accomplishing by its design. This includes learning where to look for patterns, what type of patterns to look for and other criteria that can further filter results.

It has been written that phone numbers and license plates have only seven digits because that is what the human mind is capable of remembering. When using a program such as Autochartist it is important to develop a core set of rules, patterns and criteria to follow. Try to keep the number of markets or criteria that you follow at seven so that don't get sensory overload and begin to suffer from "analysis paralysis".

Keep in mind throughout the process that there are no short-cuts to becoming a successful trader. You must commit to practicing discipline 100% of the time. Learn to use your analytical tools like Autochartist effectively and efficiently to help you grasp the mechanics of trading which is 10% of the game. Once this is accomplished, create a plan that you can follow and adjust the plan as market conditions dictate until you find something that puts you in your comfort zone. It is only in reaching this zone that you can then begin to master the psychological side of trading which is 90% of the trading puzzle.

TRADER SIZE DOES MATTER

Endurance is one of the most difficult disciplines, but it is to the one who endures that the final victory comes.

Buddha

Most traders spend a lot of time on developing their entry and exit strategies, but very little time on the size of their trading positions. So while wins and losses do matter, how big your trading position is when you win or lose will have a direct effect on your bottom line.

Trading systems are subject to both winning and losing streaks. The assumption a trader should make when trading is that after a winning trade, a winning streak may be develop, but conversely after a losing trade, a losing streak may be in the offing.

To take advantage of the streaky nature of a trading system, the trader must consider a strategy whereby he increases his size during winning streaks, but decreases his size during losing streaks.

When building a trading strategy, and studying the back-tested results, the trader must be aware of his trading statistics. Among the many statistics produced, consecutive wins and consecutive losses are most important.

Too often a trader will try to catch the “big winner” while having on big size. Since no one can really predict the “big winner”, a trader may get caught with big size on during a losing streak. Taking on a position that is too big during a losing streaks means you will eventually have to catch huge winning trades with similar size in order to make up the loss.

TRADER SIZE DOES MATTER

Therefore it is better to have a position sizing equation to take advantage of the streaky nature of your system and the unpredictability of the size of the market swings.

One method to consider is sizing positions according to a percentage of your trading account. For example, a trader may consider risking 1% of his account on a position. This is the money management portion of his trading system. This has nothing to do with the trading system itself.

After determining what 1% of his account value is, a trader then divides the risk of the trade into the percentage risk of his account to get his position size. For example, if 1% of your account is $1000 and the risk on the trade is $4.00, then the size of the position will be 250 shares.

During a winning streak the size of the account will increase and so will the dollar risk of the trade, but it will still be set at 1% of the account size. If 1% of you account increases to $1500 and the risk on the trade stays at $4.00, the position size will increase to 375 shares.

TRADER SIZE DOES MATTER

If the trader should experience a losing streak and his account decreases in value, then 1% of his account size may fall to $750. If risk stays at $4.00, then the size of the position will be decreased to 187 shares.

This is only one sizing methodology. There are others and all should be applied to your trading system to find the proper fit. The idea behind this tactic is to take advantage of winning streaks by increasing size and to prevent a massive drawdown in your trading account during losing streaks.

Traders should note that this style of sizing will only work if your system has a positive expectancy. In other words, if the trading system is good, position sizing will matter to the bottom line. If the trading system is bad, then proper sizing will not save it.

Using a sizing method based on percentage of account risk, a trader may be able to use wider stops when choosing a chart pattern suggested by Autochartist. This may mean he will be able to accept more trades since his position size will be based on a fixed percentage of his account instead of a flat dollar amount. This tactic is likely to help when accepting or rejecting trades.

TREAT A WINNING OPEN POSITION AS IF IT IS YOUR MONEY NOW

> Failure is not fatal, but failure to change might be.
>
> *John Wooden*

Traders often hear that you should never turn a winning trade into a losing trade. Accompanying this statement is usually a comment about greed. In my opinion, greed has nothing to do with the decision to let a position ride or to cash it in at a small profit.

Often a trader in a winning position wrestles with the discipline he has developed which tells him to follow his system. Sometimes to a fault, a technical trader will hang on to a winning position in an effort to squeeze every penny out of the move. In his head he is telling himself, “I will not override my system” or “I am only going to exit when my target is reached”.

This type of thinking can be overcome if a trader begins to realize that the open position profits are his now. This may mean developing a defensive-type mentality about the position rather than an offensive mind-set. In order to overcome this problem, a trader may begin to focus more attention on his trailing stop strategy. This may include making stop adjustments based on specific chart points or changing the stop based on a percentage of open position profits.

Being too rigid as a trader, may lead to his own undoing. If you hang around successful traders long enough, you may hear the expression “trading is an art”.

TREAT A WINNING OPEN POSITION AS IF IT IS YOUR MONEY NOW

This means that although fundamental or technical analysis may help you find the trade, "art" takes over when you are trying to enter or exit the trade.

Just like a sailor sets a course for his destination, a trader must have a well-laid out plan. In addition, like a sailor, the trader must be aware of the dangers of not adjusting to the problems that may occur during the course of the trade. Although he is focused on staying on course, the sailor may be constantly adjusting his sails to catch the wind. These adjustments are critical to his reaching his destination or goal.

The successful trader must also be flexible like the sailor and make critical adjustments during the course of the trade. This may mean lowering a target objective, trailing a stop or adjusting his position. Ultimately the goal isn't to reach the optimal objective on one trade, but to be successful with a series of trades over a long period of time. So pitching a profitable trade early is by no means being undisciplined. It is at this point that a trader begins to learn about what his system can and cannot be asked to do.

Over time a trader will learn key characteristics about his system such as how much of an influence volatility has on his methodology or how sensitive his stock is to shifts in volume. While looking at his trading stats, a trader will become aware of his system's Maximum Positive Excursion. This is a measurement of how much open profit is generated in a position. This statistic will help a trader realize how money his system realistically generates. Also when compared to actual closing profits, it will let him know how much money he leaves on the table.

YOUR AVERAGE WIN MUST EXCEED YOUR AVERAGE LOSS

> I've missed more than 9000 shots in my career. I've lost almost 300 games. 26 times, I've been trusted to take the game winning shot and missed. I've failed over and over and over again in my life. And that is why I succeed."

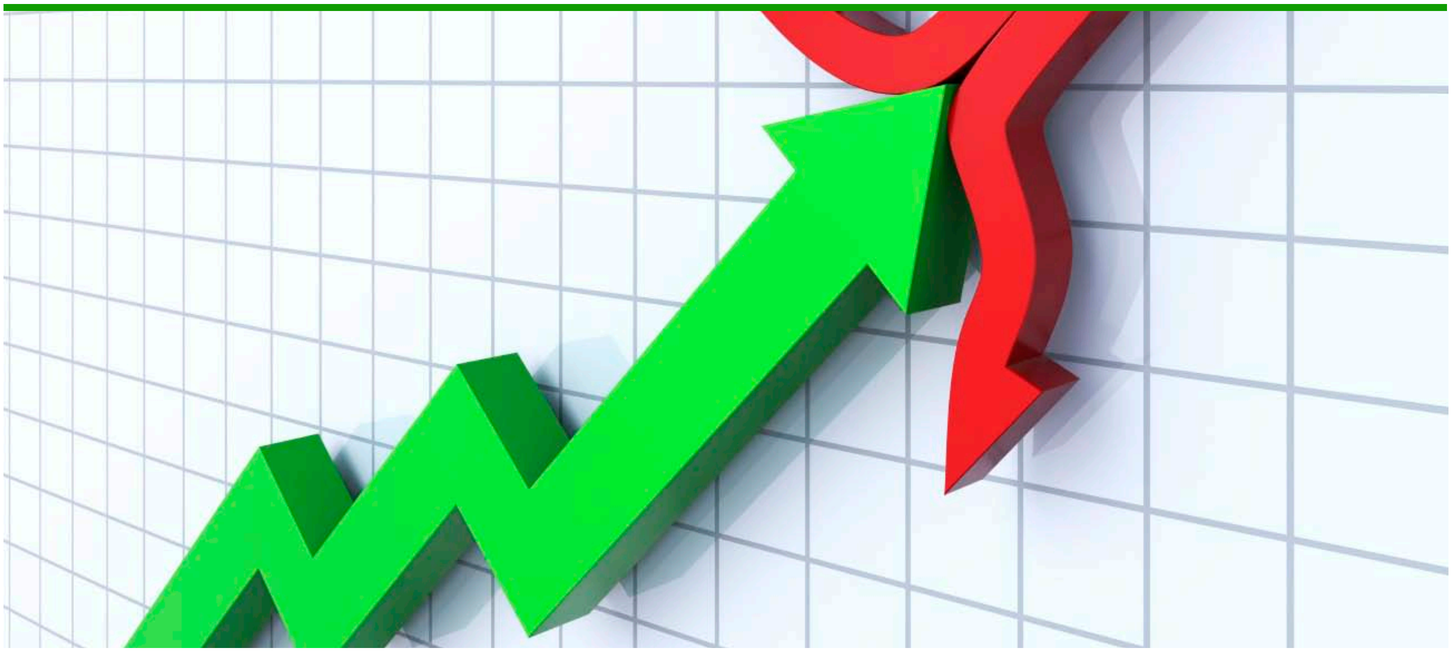
Michael Jordan

> "Your average win must exceed your average loss" is a powerful statement because it flies in the face of those who believe that a high winning percentage is the key factor that makes a trader successful.

Everyday I am bombarded with ten or more ads for trading systems touting 70, 80 or sometimes 90% accuracy. These emails go straight to trash because in my opinion the accuracy of a trading system is not as important as the size of the average win compared to the size of the average loss. In fact if you press the salesman of these systems for this particular statistic, they are often dumbfounded that you were even asking the question. This is because people like accuracy. They like to know that they have a high probability of being right. In the long-run, trading a system with a high percentage of winners will most likely lead to losses.

Many systems experience a quick gain after the initial entry. If one were to capture this quick profit, his accuracy would be high; however his average win would be low.

YOUR AVERAGE WIN MUST EXCEED YOUR AVERAGE LOSS



Think about a system that is 90% accurate. It is possible to catch 9 or more trades in a row that generate an Average Profit Per Trade of $.50. But what happens if that one loss was $4.00?

This means that the trader must have at least 8 trades in a row at $.50 per trade or better to make up the one loss. So when you get an email mentioning the accuracy of the trading system, always ask about the size of the sample and the size of the average win and the average loss.

A good trader maintains these statistics because it will tell him whether he is exiting his winners too early or holding on to his losers too long. In addition, it will help him develop the discipline to follow the strategy. Finally, from a psychological standpoint, it may indicate that the trader is working with scared money. A person cannot become a successful trader if he is afraid to take a loss. Read the Michael Jordan quote again and think about how it applies to trading.

YOUR AVERAGE WIN MUST EXCEED YOUR AVERAGE LOSS

A high Average Profit Per Trade is a number that confirms that a person has learned to maximize the profits of a successful trade whether it was nursing the trade until it reached its target price objective or trailing a stop to prevent giving back too much of the profit.

A high Average Loss Per Trade may mean that the trader has been experiencing a large number of maximum stop losses. In this case, this may mean the entry signal is flawed. It may also mean the trader is not using stops or moving the initial stops away from the market because he fears taking a loss.

A good trading system must demonstrate that the Average Profit Per Trade minus the Average Loss per Trade is greater than 1. This is the expectancy of the system. The higher the number the better. Keep this in mind when trading because it means that you can be a 50/50 trader, but if your expectancy is high, you can still be successful.

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