THE
Forex
JOURNAL

WINNING TRADES
BEGIN HERE...

The 2010 Currency Wars...

*(...The why
and the where to?)*

Also Inside: TECHNICAL INDICATORS AND TRADING SYSTEMS, THE ARTFUL TRADER PART 3, REFLECTIONS OF CURRENCY BEHAVIOR, TRADING WITH HIGH PROBABILITY ELLIOTT WAVE PATTERNS, REFINING YOUR TRADE PLAN AND STRIKING GOLD IN YOUR TRADING...

size. At this point in the trade, we can either follow our plan or succumb to the emotion of greed. Greed causes a trader to ignore his plans and take positions that ignore proper risk management, or which do not stack up in terms of favorable odds.

Once a trader succumbs to greed and has too much at stake, his level of anxiety increases. The anxiety is driven by a fear of losing profits or of making losses. Unless the trader manages this anxiety level, by being aware of the cause of the anxiety and reverting back to a rational, rather than an emotional management style, the next emotion that will be experienced is that of fear.

Fear is a much stronger force than greed once it becomes entrenched. When a trader starts losing money, he has to act quickly to stop the bleeding. If many traders are in the same position, as is often the case in bubble environments, the result is a drastic collapse in prices causing the fear factor to be magnified exponentially. This leads to more cuts and ultimately a state of panic.

When panic floods into the market, traders who have poor or no planning, find themselves forced to capitulate taking heavy losses. This cycle is typical of the herd mentality where everyone has jumped on the band wagon in a desperate attempt to make money, usually in a situation where they have inadequate or no rational planning.

Examples of this cycle can be seen in the recent dot.com boom and bust and even more recently the housing boom and bust. This is human nature at work but an "Artful Trader" knows that he can step aside from this cycle because he is aware of its existence.

By managing your emotions and by being disciplined, patient, objective and realistic, you can avoid the boom and bust cycle. The proper way to ensure that you do not succumb to your emotions is by conditioning yourself to have a trader's mind set, one that will set you apart and prevent you from being caught in the herd. **TFJ**

Selwyn Gishen is a trader with over 15 years of experience trading Forex and equities for a private equity fund. For the past 35 years, he has also been a student of metaphysics, and has written a book called Mind: How Changing Your Mind Can Change Your Life! (2007).

Gishen is the founder of forexnewsandviews.com and the author of a Forex trading guide entitled Trading the Forex Markets: A Foundation Course for Online Traders. The course is designed to provide traders with all the aspects of Gishen's Fusion Trading Model. He writes educational articles for Investopedia, a Forbes online investment educational site, as well as for The Forex Journal. He has been a guest speaker on Forex trading for Tradestation Securities.

This article is a reprint with permission from Tradestation®, Inc.

Money Management, *con't from page 55*

The names given to the variations of money management rules are pretty descriptive. I will match them to the color in a list to make viewing easier.

Black = Overnight
Red = Money mgmt stop 0.5 Target 1.5
Green = Money mgmt stop 0.5 Target 1.5 Trailing stop 0.5, 0.5
Blue = Money mgmt stop 0.5 Target 1.5 Trailing stop 1, 0.5

One of the more interesting setups is the one with the Stop at 0.5 and Target at 1.5 without a Trailing Stop. How do we do that? By setting the Trailing Stop Trigger to a very large value that is larger than the Target, then the Trailing Stop will never get triggered. As you can see, money management rules have worked magic with this system.

MORE ABOUT MONEY MANAGEMENT

What amount to risk? If you have a $50,000 account and would like to set your risk at 2%. Risk amount = Account size x 2%. Risk amount = $ 50.000 x 2% = $ 1.000.

Calculating proper trade size:

(Risk amount – Commission / Difference between Entry and Stop) / (Entry / Stop Difference). So the risk amount minus commission, divided by the difference between the entry price and the stop is the trade size in number of shares or contracts.

For example: $1,000 maximum risk – $10 commission divided by $ 1.25 (the difference between entry and stop) calculates that you can trade 792 shares.

CONCLUSION
Proven Money Management Techniques:
• Always use stops
• Use a proven and tested methodology for stop calculations
• Use proven and tested trading systems
• Adjust trade size to maximum of 2% risk
• Never exceed the 2% risk of your trading account size
• Never exceed the 2% risk in a given sector
• Always trade money you can afford to lose
• Never trade borrowed money
• Limit the use of leverage

Money management is a must to live more safely in trading the financial markets. For a trader to blindly enter trades simply because they are thinking positive thoughts is to ignore the full area of what can happen. To trade only in fear of losing will cause a trader to trade with fear, anxiety, negativity and aggression, which are equally destructive. Instead, look at both sides of the coin and use active money management and risk control. **TFJ**

Ron Schelling is an independent trader in The Netherlands with over 25 years experience in Forex and futures arbitrage trading. He can be reached at www.2hedge.com.

Money Management

Used properly, money management techniques can dramatically enhance the performance of a trading system. Ron Schelling discusses various money management tools and how the use can enhance the results of a trading system.

The subject of money management is a broad area with many options, but its use is necessary to survive in trading today's volatile financial markets.

If used properly, money management techniques can stabilize or dramatically enhance the performance of a trading system. On the other hand, if money management is used improperly, it can adversely affect the results of a trading system. In this article, I am going to discuss the general rules for employing money management orders and demonstrate how to write a basic money management strategy that works.

WHAT IS MONEY MANAGEMENT?

Money management is the act of managing open positions in a trading system based on current profitability, relative performance to other market positions or statistical behavior computed from historical testing.

The principle behind money management is very simple – if profits can be taken before they vanish and losses reduced before they grow in size, a trading system should, in theory, make more money and be easier to trade.

There are 3 basic types of money management rules
1. *Stop Loss*
2. *Trailing Stop*
3. *Profit Target*

STOP LOSS

Stop Loss is the concept of closing out a position when some predefined level of loss is reached. The predefined level could be a fixed amount of money or a fixed number of points from the entry price point. There are many ways to define the stop loss level.

TRAILING STOP

Trailing Stop is the concept of protecting the profits of an open position. Usually, a trigger level has to be reached before the trailing stop orders are placed. The trigger level can be a fixed amount of profit or a fixed number of points from the entry price. Once the trigger level is reached, the trailing stop order is placed to protect a certain part of the current profit.

PROFIT TARGET

Profit Target is the concept of taking a profit while it is to your advantage. A predefined level of profit is set and when that level is reached, the system exits the position immediately. Predefined level can be anything from a fixed amount of profit, a fixed number of points from the entry price, to a particular price level like the previous month's high or previous trading day high. Usually, profit target rules are implemented through the use of limit orders.

GENERAL TIPS IN APPLYING MONEY MANAGEMENT RULES

1. Apply money management code only after the system shows some form of consistent profitability.

2. Avoid using money management orders whenever possible.

3. It is a known fact that the further you place your stop loss orders away from the price, the higher your percentage of winning positions combined with an increase in drawdown size.

4. It is a known fact that profit target rules can boost profitability significantly. Profit targeting may not work going forward, unless your targeting rule takes into consideration adapting to current market conditions.

5. By using optimization on money management rules, it is possible to turn most non-performing trading systems into profitable systems. Such results are not sustainable going forward because it is curve fitting the system against the historical data.

STATIC VALUE VERSUS VOLATILITY ADJUSTED VALUE

Most beginning traders design trading systems with static values in their money management rules. You cannot blame them because most trading software provides canned money management options so everyone can optimize their systems to show some form of profitability.

A more appropriate approach is to use adaptive values that change based on market conditions, not a fixed value chosen arbitrarily by the user or optimizer.

For example, if you designed a trading system that has a fixed 3-point profit target, it may work at current price levels, but it may not work when the price level has changed to double the current price.

MODIFYING AN EXISTING SYSTEM

Another issue encountered when adding money management code to an existing system is that you have to properly modify the system so that its entries do not change. Otherwise, you will fall into the trap of developing a new and different trading system without realizing it.

For example, if your system takes an oscillator signal when the indicator reverses from overbought and oversold conditions, you could have multiple buy signals without a corresponding sell signal. If your money management rules take you out of a current position, should your system take consecutive signals in the same direction that follow? In most cases, it is best that you do not let your system re-enter a position in the original direction unless and until the original position has been offset.

AN EXAMPLE

In this article, we will use a basic moving average system that works consistently as a daytrading system, but less so when positions are held overnight. Can money management techniques help improve the results? Notice we are dealing with e-mini S&P data over so many years. The price ranges from 800 to 1500, which is a huge variation for any static money management rules to work properly. We need something that is more robust to consistently describe our rules.

The technique used is a volatility based method using average daily range. The reason is obvious, since we keep positions overnight. We need to be able to work with the volatility of the daily changes in the e-mini S&P. All stop loss, trailing stop and profit target are described indirectly as a fraction of the average daily range.

Here is a comparison chart showing how the system performed with various money management parameter settings.

© Chart is created with Neoticker Software