PLANNING YOUR TRADES

Generally speaking when new traders start trading, they do not place too much thought into their trades. Most new traders will either just buy or sell a currency pair because they think that they see a trend developing or maybe they have placed a moving average on a chart and decide to enter a trade based on the view on their screen. Other times, there can just be no reason behind placing the trade, other than they just want to be trading something.

I know this sounds crazy, but if the trade nets a small profit the new trader feels that trading is so simple anyone can do this and enter more trades based upon the same criteria. Naturally, the new trader expects all trades to be profitable ones. When a trade starts to move against the trader, the initial thoughts are most probably, I will sit in front of this machine until it breaks even and then I am getting out…breathing a huge sigh of relief if that happens.

After time, the trader who may have had a few profitable trades with a hap hazard approach then gets a negative trade and after a big loss on their broker account, reacts in "revenge" by entering a large trading position in an attempt to recover the prior loss. That trade may also be a loss making trade that crushes their broker account, or if not that trade but one soon after….

Does this sound familiar?

The reasons that so many new traders "blow" their broker accounts is that they assume that trading is easy. They do not realize that emotion plays a huge part in trading psychology, in particular, when you are using real money rather than a "practice" account, and they have no TRADING PLAN.

As you probably know, it doesn't take long to learn that trading isn't easy. This is why using a TRADING PLAN is the main way to help with emotions and develop a consistency with trading. If you enter at random places and exit when you have a "gut" feeling to do so, you are probably in for a lot of pain.

Successful traders have a TRADING PLAN. These traders do the same thing every time, only very occasionally tweaking one aspect of their plan at a time. Trying to make wholesale changes at once makes it impossible to tell what is working and what is not.

Before placing a trade it is vital to identify your entry, stop and profit targets before entering the trade. If you try to determine your exits once in the trade, emotions have a tendency to skew your view of all the facts, that is of course unless you have the ability to be a robot. If you know your exit (your risk) before you enter the trade it is harder for emotions to become involved. It is also a very major step in keeping you as a trader disciplined. It keeps you trading in line with your TRADING PLAN.

In my trading, blogs and tweets I often refer to the risk / reward ratio. This is something that I use all the time before entering a trade. I know the risk first. This is critical to be a successful trader. If you do not determine the risk / reward before placing a trade you are not adopting ACCOUNT MANAGEMENT.

A quick way to measure risk / reward is as follows: Simply divide the distance between the entry and the profit target by the distance between the entry and the stop. Everyone has a different concept of what is a “good” risk / reward ratio. A good guideline is around 1:1.5.

Once you have your entry and stop sorted out, next is your position size. Your position size should be the same percentage of your equity in each trade. Many traders will tell you that they risk between 1-3% on each trade, and they use the same position sizes every time. In other words all trades are weighted equally. The same capital is risked on a trade with a 30-pip stop as a trade with a 300-pip stop.

In order to determine your position size, multiply you're your total equity by your percentage risk per trade (1-3%), which is the amount of money that you should risk per trade (X). Next calculate the number of pips between your entry and the stop by the currency’s pip value (Y). Then divide X by Y and you should have the number of lots that you should trade. Once you get practice at this it is easy.

RISK EXAMPLE:

BROKER ACCOUNT BALANCE = $5,000.00
CURRENCY PAIR
EUR/USD
ENTRY LEVEL is 1.3750.
1% of risk = $5,000 x 1 /100 = $50 (X)
Fib level for STOP = 1.3775 plus wiggle room of 10 more pips = 1.3785 total of 35 pips
X divided by Y = 50/35 = position size 1.4 lots.
The above (1.4 lots) is the maximum position size based on 1% account risk.

Now, I trade with MICRO, MINI and STANDARD lots depending on the currency pair I am trading. To accommodate this variance, I adjust the values accordingly to ensure that my risk tolerances are not exceeded. I use different brokers for different trade styles, different position sizes and the brokers have different sizes of balances to reflect this. This is another layer of calculation, but when it’s done once or twice it becomes second nature.

By planning your trades out before you enter, you can trade on any time frame because you are risking the same amount for each trade. This will lead to much more consistent results.

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