

2 TRADERS

[EP130: Relativity \(Part 2 of 2\)](#)

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Darren: Because for me, trading is just a vehicle for me.

Walter: Vehicle? I agree. It's a vehicle for freedom....

Announcer: Two Traders, Darren and Walter, pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the Two Traders Podcast.

Walter: In Part Two, Darren and I tackle what traders can learn from the UK Pension Fund Scheme; How to reduce your overwhelm when it comes to setting your trading goals. We'll talk about the retired trader who is a hazard on the road and why.

The motivation behind trading that's nearly universal for all traders. Why you must lock in to this one thing when you are setting your trading system up and going live. And, what business is going bust have to do with traders.

And finally, we'll figure out which is the best band. All these and more in Part Two of the Two Traders Podcast.

I think that potentially -- even though I think that everyone can do it -- I still think that, potentially, there's a really tough road for some people and perhaps an easy road for others.

I feel like one of the interesting about our discussions is that you were -- to me -- you were someone who is very good in the world of ideas. Like that's where you live. You live in the world of ideas.

Naturally, it would -- and an extension of that -- someone will come to the right approach for their trading. When they happen upon the right idea, you know what I mean? That's just my take and it could be off but that's how I see it.

For example, I know a guy who's retired now. He's a former trader. He traded for really famous diamond company. They're dealing in diamonds and currencies around the world so he would trade different currencies and hedge their risk in currencies, things like that.

This individual also had a stroke. He drives around in his car and it's totally trashed on one side because he probably shouldn't be driving. When I see that, I think is there also somebody else out there in the same situation as a trader.

It's kind of they're driving their platform, they're going along, they've got their account but they shouldn't really be doing it. It's a little bit dangerous because yeah, they can do

it, they can make it, it can happen but the way they're travelling right now, someone is going to get hurt.

Darren: I see your point now, definitely.

Walter: It's tough.

Darren: I suppose so but I don't know. I mean, you kind of have to factor in other things like luck and chance as well. You can be an amazing Physicist, great with maths and you've come to trading.

You've got this idea that is like a math problem or a physics problem. You've just need to get everything right and you've sorted yourself the problem, that's how you've always approach stuff.

So, that is how you approach trading and you can't get it right because your approach is too narrow and you are not seeing the big picture. And then, you could go on holidays somewhere and sit down at a bar and start chatting to someone and the light bulb can go on and you could just start to see a chance meeting or you could stumble on a web page that just sparks an idea. Or, you're saying that those sort of people would just, they would miss those opportunities?

Walter: Maybe, I don't know. Or maybe, they've got their risk all upside down. Maybe they have the system. It matches up, they can execute it but they're just driving it to the ground because we're all somewhere in the curve, on the risk curve.

Either over the edge and we're headed for destruction or we're on the conservative side where we are not going to maximize our returns. So maybe, some people are always pushing the limits. They always have their foot on the gas pedal so to speak and they just want to go hard. That is just not compatible with trading.

Darren: I find it very difficult because I see most trading systems that I look at, I see a good probability that they are profitable. So, I'm seeing say, 70% of trading systems that I look at are profitable and then on the flip side, you've got a large majority of traders who aren't profitable.

So, I see the problem as what is going on there with the majority of strategies being profitable and majority of traders not being profitable. There has to be what's the connection that's breaking there. Although a kind of complex difficult problem, I see it as really being fairly simple to solve.

Walter: But sometimes it's the deceptively simple problems that they're seems so easy to solve but no one was able to do it. Like if you look at the, I've seen the statistics on the new businesses.

For example, the new businesses in Australia, they have, it's something like in 4 years, 80% of the businesses fail. They're no longer in existence 4 years from now, there's only 20% left or something like that.

If you think about it, these businesses aren't silly. They know and understand that they're not selling their products or their services at a loss. They're know what their expenses are and yet they still end up losing or throwing in the towel, 4 years later. The vast majority of them.

How that can be? It's kind of what you are talking about like there are all of these free trading systems out there for you to pick up and use. You can make them work and yet, we know that most of the traders just start doing this. So, it's a user error.

I think that is what the software people would call it, user error. Is that what is going on? That is what we end up always on this podcast. If this is your first episode, I apologize but we end up going back to the Psychology of it.

So that is where we are at, I suppose. It's that, it is being aware of what you're doing and understanding what you need to do, essentially. You've got this trading system, it's going to make money, it should make money and it is designed to make money but how do you kick it and how to make it work? It is really about understanding what you were doing.

Darren: I think a lot of were that. We've solved the problem, we've got what we really want. We've got a strategy that has a positive expectancy but we either check-in the towel too soon or we execute it wrongly.

I think that's the disconnect that goes on or we want to be too far outside the curve. We want to double out account every month with a strategy that is going to double it in 5 or 10 years.

The majority of strategies are much closer to that average than they are way out there but we all want to be way out there, don't we? We don't want to be average. Actually the place you want to be, the safest place to be is near close to the average. It's just above it.

Walter: In the middle. I think part of it, is we focus on -- what you're saying -- we focus on the doubling the account and we don't look at the other side of the drawdowns that are part of that.

Darren: Definitely.

Walter: When we're living as a trader, we are somewhere on this equity curve. We could be a little valley. We could be a bit of a peak. More likely than not, we are somewhere in between the peak and the valley.

The question is, how bumpy the ride do you want? Like in Disneyland, they used to have -- this is a long time ago now, but in Disneyland -- we used to go there and they would sell you these tickets. Certain tickets will get on certain rides and the E Ticket was the scary, space, mountain roller coaster ride.

The A Ticket was kind of like a Dumbo or Carousel or whatever and so, you wanted to save you E Ticket for the really good ones. I kind of look at traders the same way where we have, some traders are like they're locked-in.

They want that E Ticket, their goals, they understand it's going to be a bumpy ride. They may blow up or whatever along the way but that's the risk they are willing to take. And then, there are others who, they just want to ride Dumbo. They do not want anything too exciting. They just don't want to lose it all and so they are okay with the little shallow peak, a little shallow valleys and small rounded peaks, I suppose.

Darren: You can't really argue, one is the right way and one is the wrong way either.

Walter: Yeah, absolutely. But I suppose, a lot of traders don't even think of it that way. The number of traders that say, "I'll risk 1% or 2%" or whatever, they don't look at it in terms of what's my goal? What is my criterion?

Is my criterion to avoid the 15% drawdown or is my criterion to make 300% in the next two years? What is my criterion? And you build everything off of that, to me. I mean, it just seems obvious but I suppose, I didn't do that when I first started trading. I didn't look at it that way.

I just said, "Okay, this looks pretty good. I'll risk 2%" and see how that goes. My backtesting looked alright at 2%. I didn't look at it from the perspective of my goals should dictate my actions.

I think that -- I don't know if that's common or not, I think it is -- most traders, they'll just say, "What can I make with this?" and they don't look at it from, you actually have a lot of leeway there. You can direct that trading system in many different ways with how you manage your risk.

Darren: Do you think half of the problem is that, we're always thinking or we're always drawn to thinking too shorter time horizon. I very rarely hear any traders say what their 10-year plan is but I've heard a lot of traders say they want to make a million in a year. But you very rarely hear someone say, "I'd like to make 40,000 a year in 10 years time."

Walter: Right.

Darren: Which one is more realistic?

Walter: I think there's a lot of that going on in life. You don't hear the sports star say, "We'd really want to win a World Cup in the next eight years." They want to win it the next World Cup or that kind of thing is pretty common. They're short-term thinking.

Darren: Yeah. There's a thing with pension contributions in the UK. There's an economist called Roger Thaler. He worked with the British government because they have this pension scheme where if you contributed a small part of your wages to your pension scheme, the government would match it.

And, if you work this out over a long period of time, it is really a good plan for you to do but you have to enroll yourself and they found out that the take out was really, really low. Roger Thaler said to them was just auto enroll people and then give them the option to opt out.

Walter: And take out, yeah.

Darren: Yeah and the take out swing has been massive. What they found out was that, even though it's a good plan, it's good for you to sign up for this. It is a long term plan and in the short term, people are just too lazy to fill the form out.

Whereas, if the form has already been filled out for them then they're too lazy to opt is out so they'll just actually stay in. We really kind of battle against any long term ideas because we're just entrusting what's right in front of our noses in that moment.

I think it's the same with trading. It is really hard to push ourselves into something, into a long term plan. Even when all of the data and the facts are in front of your eyes. Look, you can really achieve your goals but it's going to take a little bit of time and you're going to have to stick to your plan. Even when faced with that information, it's really hard for us to do it. Even smart and intelligent people.

Walter: Do you think there's a selection bias though? Do you think that there is a self selection bias where the people that are drawn to high leverage trading such as currency trading are really, they are just looking for a vehicle for quick short term millions.

It's kind of like rock and roll bands or whatever, is it that drug addicts seek out music industry or is it that the music industry grows drug addicts? You know what I mean? Like, what came first?

Darren: Are you saying that essentially currency trading attracts the sort of personality should really, shouldn't be currency trading?

Walter: Well, maybe not. That's wrong. Maybe something along the lines of maybe this is the kind of thing that's self-selects for people who have these sort term goals. I think that the share traders are much more deliberate.

Like, the share traders that I've run across, they're predominantly share traders and the "double my money" guys are in forex, they've come from a completely different angle.

Darren: Right. I was at the kind of impression that, that is a problem for every one and you are suggesting that it's more of a personality trait.

Walter: Maybe. I'm just floating it out because it seems like, I know for example, I've heard people who have told me. These are traders I've met, shall remain nameless but people have told me, "Hey, I'm a forex trader. I'm going to off and flip houses" or another trader says, "I'm going to get into internet marketing" and to me that is like red flag.

It's like, these guys don't really, trading is just like a thing that they are dipping their toe in. They don't really eat and breathe trading. It's just kind of like this is a vehicle for them.

Darren: Oh, that is difficult now that you say because for me, trading is just a vehicle.

Walter: Vehicle. I agree. It is a vehicle for freedom.

Darren: I'm not actually really interested in trading. It does not inspire me. It doesn't excite me. It's a vehicle for me. But at the same time, I am really interested in human behavior.

Walter: Exactly.

Darren: Psychology. That is something that what was not there originally. Originally, I've got into trading just because it was a vehicle that could...

Walter: Freedom.

Darren: Perhaps. Some experiences or benefits that I couldn't quite achieve through my other work and profession. So, originally that was the vehicle for me and is still is in trading but I've developed an interest in behavior Psychology.

Walter: I would that, that is the trading. What you're saying about your interest in human behavior essentially, that's it. That is trading. In the end, you do this long enough, you're probably going to come to a conclusion that looking in and seeing where you are at as a person and understanding what you are doing, that is trading. That's what it ends up being.

I don't care if you are using an automated EA, super robot black box whatever 2,000 system, it is the same thing. That will be my argument.

Darren: Yeah, I would agree as well. If you'll look at the history as well, I think Behavioral Economics is perhaps considered and Psychology side is perhaps considered a new field. If you'll look back, it's always been around and from what I've read, initially that was more important than the Economics side of it.

And then it seems like we went through to a period of dismissing that and it being more technical and about the numbers and now it's kind of coming back in vogue. But there's still a little of it on the trading forums and that puzzles me.

The biggest trading forum that I know in terms of the numbers of people hardly ever touches on it. I go check on it everyday to see any post about it. I don't see anything on that. I really don't. Not one trend, not one suggestion that it might be an issue.

Walter: But don't you think -- and I could be wrong here -- don't you think that the seekers on the internet, they are looking for trading systems? And the people who've figured it out how they are going to interact with the market, they've got their instruments.

They've got their systems to use, they've got their tools. They just go off and they've gone off someplace else. They're beating the drum in the (Ed Seykota) Trading Tribe in Toronto or whatever.

Darren: I suppose there's no real point going into sides and arguing.

Walter: It's true. You go into these forums and you'll see some really insightful post and then inevitably, you'll scroll back and look. Go to the profile and oh the last post was 2007 or whatever, they've gone. It's a ghost town. They've left and they've left it to the jackals to go ahead and tear at the meat.

It is funny but it ends up being that way. I agree though, I think that's pretty clear when you look around. I remember, there was a guy in one trading forum that should remain nameless. He would just send everyone off and I think that is what he wanted to do.

He wanted to just fire people up. This is back in 2003-2004. He wanted to fire people up and I talked to him a couple of times on Skype because he would just rail against everything.

He got kicked off a few times or whatever. We've all seen this happened and he said to me, "You know how Rambo? The movie, Rambo?" I don't even remember this in Rambo but apparently it is, and he said, "The guy, he is the weapon" or something like that.

He is like, "Yeah, that is how my trading is. I've learned it from this guy in China and he taught me how to do it." He was talking about how he never uses stop losses and he just keeps averaging into his losers and all this stuff.

Everyone was saying, "You're an idiot. What are you doing? You're crazy." It was so entertaining. I think that's part of why people go there. They are looking for the magic system and they just want to start a fire or be entertained or whatever.

Once you get into it, you just go off and you'll look at the Behavior Economics or you'll get interested more in Psychology. A lot of these things out there can help you or maybe you'll get into meditation or hypnosis or journaling or whatever it is. You've kind of grow into it from different angle.

I think in the end that is what it is. That's what it is. Trading is that. In the end, it's just understanding you.

Darren: When they get into theses debates, wanting to come around to the consensus that they are right and it is difficult, isn't it? Because, it is good to debate these ideas and it is good to argue different sides of an argument. I think the language you use when you have these debates, really says a lot about what you're trading is like.

Walter: How do you know that? So, what are you looking for when you say it? I think I know what you are saying but when you say the language what do you mean?

Darren: Even subtle things like saying, "This is the best exit." Using the term "the best" or saying technical elements don't work and technical elements do work. Being really specific I think, is always a sign that there are issues there but you have to have these debates. It is good to argue these points but you have to consider your language when you are arguing these points.

Walter: Well, everybody knows that the Beatles were the best band, hands down.

Darren: Exactly. In my group this week, we had this very debate and...

Walter: About the Beatles?

Darren: Not the Beatles but they did come up later down in the thread. One of my members posted, which is the best trader: Trader A and Trader B? Trader A had a very low win rate but high risk/reward and Trader B had high win rate and a smaller target.

Based on the other facts, the guy with the smaller target, had a better shot and in the test that we were examining, Trader B had made the most profit. Then the debate was, about which one is best and I took exception to this saying, "They're both making profit so, you cannot really say which one is best and you can't just break it down to profit for many reasons" because for instance, Trader A who has much lower win rate and higher risk/reward, would not really see if there was any advantage -- any advantage in the short run test, say a 100 trades. But over a 10,000 trades, the figures would be very different.

My argument was just using the term "best" is not really helpful in these scenarios and that is kind of an approach thing that's, if you are trying to decide how you want to trade yourself then, it is obvious that you're going to think in these terms. But you also have to remember that the best for you is not best for Trader B or Trader C. So I think, language is important and it says a lot about your bigger picture and bigger view of trading.

Walter: And I think, sometimes in the beginning there's a tendency to just defer to others and saying, "You are more experienced than me, Darren. Tell me what the better one is" or something like that.

Maybe, that's part of it but really, obviously what you should be doing is looking at what makes sense to you. What is your criterion and what are you working on here. Is Sharpe ratio, is that really what you're going for?

Darren: Any of these measures in a field like trading, like sharpe ratio, there is advantages for sharpe ratio used but there's also periods where the way it looks at data, it tends to discard certain conditions. So, it is not always perfect but if your belief is that sharpe ratio is the best then sometimes, there is an advantage to use something that might not be the best but you believe in it. Those things need to be considered as well.

Walter: Yeah, absolutely. If it means that you are going to stick with it or it is easier for you to execute it then, go for it. And sometimes, the numbers don't make sense. Sometimes, they don't actually fit the data.

I remember, I was trading a like-grid trading strategy and I had options to cover the downside risk. I was going into the Trading Tribe in Sydney and we were comparing our -- you are not supposed to do this at the Trading Tribe but at the end of the Trading Tribe, we've actually had a sit down and have like, where we would go over our trading

statistics and stuff like that but you wouldn't normally do at the tribe meeting and they asked me for the numbers and I ran them. -- I say, "Look, this is not going to make any sense because of the strategy, the way it works" and they were all like, "What? This is amazing."

And I said, "Yes because it's like, you know, it's a grid-like trading system. It's like cheating the number." The number makes no sense when you calculate the statistics. So, that's another thing to keep in mind. It's that, you can have something where you kind of trick the number or the former doesn't really apply.

Any last words? I really appreciate your time tonight. This has been an interesting discussion about what we've learned and what we know. It turns out, not much.

Darren: An episode of really helpful advice.

Walter: At least now, we all know the Beatles were the best band. Anything else to add? I hope you can make it through the snow.

Darren: The snow stopped. I'm staying home with the charts today. I'm going nowhere.

Walter: Alright, awesome. Well, thanks for your time, Darren. We really appreciate it.

Darren: Okay, Walter. I'll see you next week.

Walter: See you next time. Bye.