

# 2 TRADERS

[EP137: Compounding Your Trades \(Part 1 of 2\)](#)

**Darren:** In the last ten years, I'm always overriding my system. I know it's my biggest failing but it has never been more profitable than it would've been just to follow my system.

**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:** Welcome to the Two Traders. It's Walter here and I've got Darren. Hello, Darren!

**Darren:** Hello, Walter.

**Walter:** How are you today?

**Darren:** I'm good. It's sunny but cold which is what the English summertime is like.

**Walter:** It's like just enough to tease you.

**Darren:** Yeah. You look out of the window and you think it's a lovely day but there's like an icy cold wind.

**Walter:** That kind of reminds me like the food you might get in an amusement park. It looks really good. Looks just enough to buy it and then you taste it. That's funny. Maybe too many Disneyland pretzels for me.

We had some ideas here, Darren. This first question that we're going to tackle, we've got a few that we're going to tackle for this episode. One is this idea and it's come through actually from a trader.

She said that, "Why is it taking so long for me to start making money trading?" Actually, 2 traders asked essentially the same question. "I'm making x percentage but it's just not enough." I think part of the deal here is that the feeling from this trader when she wrote in and then another trader when asked me this question was, "You know, I feel like it's great and all that I'm making money but it's not just happening fast enough."

I think the real question is when can I quit my job? How do I get to the point where this trading stuff is taking over and is providing enough for me? So that is the first question. What are your initial thoughts on that?

**Darren:** Firstly, it's kind of a slightly destructive mindset to focus on the money early on in trading even if you're being successful and profitable. I don't think that it is particularly a good mind set to take forward because you are starting to focus on the outcome rather than the process.

Sometimes, I mean it depends on your strategy and what your actual figures are but one of the strongest edges when you've got a profitable trading strategy is to use compounding and that is slow to take effect.

You might think, "Well, I'm making 3% a month" based on your current account, it's not enough money but with compounding, if you could do that for 2 or 3 years, you can make a really good income from that. That's one thing, it's to consider compounding.

**Walter:** Absolutely. If you're pulling profits out then obviously, you've got to be patient with it. That might mean, starting off with a smaller account or whatever it is. But you're right, I totally agree there.

**Darren:** Really what you should be looking at is, "Am I making a return each month for each quarter? -- or however yours is measured -- and is that sustainable? Am I going to be able to do that consistently or is it just that we're in a particularly favorable market condition at the moment?" If there is a good evidence that you can be consistent then with compounding overtime, you can make any returns you like.

**Walter:** Exactly right. It's like the money catches up to your account sort of thing with that curve.

**Darren:** Yeah and it takes time to get to learn patience with something like this because we do come at it to the wrong mindset. We come at it like this is going to be an income source that is nothing like anything I've done before.

Whereas in fact, if you are a consistent trader it is very similar to a sort of a salary job. You need to look at what you've got, coming in each month. You've got to look at what you've got going out and you've got to spend that excess income wisely. In trading, spending the money wisely things like saving or compounding.

We really tend to have a very opposite mindset like this is a lottery ticket and boom! You're going to make an incredible returns every month. I think we can be quite realistic about it but that force sits at the back of you mind. That's what draws a lot of people to trading.

**Walter:** Do you think part of it is like the idea that you're kind of changing the rules of the game? Most people will essentially in their work, they're kind of trading time for money. Even if you are a commissioned sales person, you generally will see your income increase the more time you put into it.

So like around Sydney, you see these guys in the real estate business. They are on their phones all day and they are showing homes on Saturdays, all these sort of thing. They put a lot of time into it and in theory, they are really only making money when they are making their sale. They could, in theory, rip off 3 sales in a week and make a big pile of

money. And so the salary per hour is pretty high but in the end, it typically is that the person that puts a lot of time in is the one that's making the money.

I'm just wondering if on the phone and all that sort of thing or whatever they're doing, they always seemed to be on the phone in Sydney. I don't know if it's part of the deal but it seemed like it is.

One of the attractions to trading for a lot of people is that, "Hey, I can get paid for not really sitting around, punching a clock like what I'd do somewhere else." And so, there's this idea that you'd go make money while I sleep sort of thing. Is that something that you think is unrealistic or we see it in one way as we're getting into trading and then later on we kind of see differently?

**Darren:** Yeah, possibly. It comes back to this idea of expectations. We seem to write our own expectations and basically ignore all of the facts. If we looked at all of the facts about -- let's say, you're a retail trader. If you look at all of the data on retail traders, the fact that you are making any money at all, you should feel pretty happy. If you're looking at all of the data but we don't have that within us.

We think, "I'm definitely at the top 3% data." Maybe the top 1% that's what we think naturally. "I'm skilled. I'm going to be in the top of retail traders. I'm going to be making the big bucks." Which is kind of like not looking at all of the facts, isn't it? All the facts are that a lot of people who started trading, they never make money at all. We need to be a bit realistic in our expectations.

**Walter:** There was a guy in the forum who was saying, "Hey, my account was begging me not to trade." Because he had seen so many accounts and so his account was like, "Don't do it. Don't do it." It was just interesting.

I thought that he was like, "Hey guys, what's going on here? My account was just saying don't do it. Is it really that bad?" Sort of the question he floated out there because you're right, the numbers are stacked up against you.

It's the same thing with acting that you have these people moving to Los Angeles every year. All these people from all around the world every year, they're just pulling up from wherever they're from. Indiana, Poland or Australia wherever they're coming from and they're going to make it big in Los Angeles. They all end up waiting on tables and waiting for their big breaks sort of thing.

I guess in a way, trading is very similar. You have all these people who've got the New Trend Masters 6000 system and they're going to take it for a spin with their broker. I think we have this optimistic view of overestimating our abilities and also seeing it like,

“Look, this is what trading is. Trading is an exciting thing where you get in and you make money.” The reality, to me anyways is nothing like that.

To me, so much of it is getting your hands dirty with data and questioning your perceptions. For me, a lot of it is, “Why did I do that?” “Why did I make that decision?” Or “Why am I thinking this now?” Or I think I have this idea that is going to make for a good trade setup, for a good system and then when I run it through its paces, it is a total crap. Why is that?

A lot of what I do is questioning not only my perceptions because a lot of times like if I look at certain things, it’s obvious that would work if I used that as a strategy. But then when I’d go and test it in Forex Tester, it comes out total crap. I just can’t make it work. Most of those things in fact, end up like that and so I’m always kind of wondering.

It’s also trade management too. If you give yourself any sort of discretion with your strategy, you’re always going to question whether or not you made the right decision. Unless of course if you’re still on the fence and make the half decision, that way you’re always right, right?

**Darren:** Yeah and the same goes for systematic approach. With the systematic approach, you’re always looking back and saying, “You know what? It didn’t feel right, that trade and if I could’ve just got rid of that rule and use my discretion then I’ll avoid all of those errors,” which again is an erroneous thinking. It is just not true.

**Walter:** It’s so true. This week, I had a trade where I was feeling really good about myself about getting 3R out of the trade and pulling up then I thought, “I’m sure we’re getting really close to the end here. I better get out of this” -- and my minimum target was 3R.

I was feeling really good about getting out there and I’ve decided to leave a very, very tiny position on and just see what happens and then of course, it just took off. In some ways, that was the hardest. It’s easier to take a loss in some ways than to have that situation where you take a profit and then you’ll look back and you’ll go, “Wow, I really should’ve waited.” Those are tough to deal with, I find.

**Darren:** I don’t think in 10 years of trading that I’ve ever performed better than my system. What I’m saying there is that in my last 10 years, I’m always overriding my system. I know it’s my biggest failing but it has never been more profitable than it would’ve been than just to follow my system.

**Walter:** When you say that, so what you’re saying basically is that you often overwrite essentially the rules that would’ve been executed had the system been automated. Is that right?

**Darren:** Yes.

**Walter:** So why not automate it? Because a lot of people are going to ask why not just automate that. What's the concern? Letting go?

**Darren:** Yes, letting go. It's fear. It's ego. It's emotion. It's bad decision making, that's what it comes down to. If we could put all electric cars on the road and they were safer than humans but they cause random derves, we'd still think that humans are better drivers. We'd still think that electric cars were a bad idea. It's how we're setup.

The only problem with automated systems is that humans overwrite them. They do it too often and they do it usually because of emotions and bad decision making but, you can find a happy medium.

**Walter:** How?

**Darren:** You can decide to be systematic in your trading but trade it manually and know that you're going to have a desire to override but you kind of use that, that's your trade. Your trade is, can I be a good trader by being systematic? Can I follow the rules? That's our trade.

It is against yourself really more than the market. The system is dealing with the market, that's what the system is there. That's built on a large massive data then your skill as a trader is executed in that. You've got a nice half-work there because you're trading like a machine.

**Walter:** But you take the credit for it.

**Darren:** Yeah. You are allowing yourself to feel that you are in an important part of the process, maybe that is what we need as humans. Now, I can see that really smart people just automate because they realized it.

**Walter:** That's true. When I think of the automated trader, the two people I think of are in the forum: Adam and Mark. I used to say to Mark, I said, "Mark, everyone is a discretionary trader because even the automated traders turn the system on and off." And he finally said like after a few years, he finally said, "Okay, I get it. I agree." He finally said, "I agree." Not that that was like a great win or anything. That was just my belief that we're always able to flip the switch at any time and kill the system even if it's fully automated.

The other interesting thing is Adam, who literally programmed these things for a Market Wizard -- literally was the programmer, creating these systems -- he's complete focus is on the discretionary trading. So I find that fascinating that the two people I know best as

sort of automated traders are both kind of, they've got at least one foot on the discretionary side of things.

**Darren:** Yeah and really when you think about the discretionary decisions you're making, now they have to be in your mind. The decisions you're making on what the market is telling you.

In your mind, your mind is making up rules about what it's looking for the market to tell you so you can trade. So you should be able to write a rule about that and if you can't then you don't really understand what the market is telling you.

**Walter:** Because you don't have a system.

**Darren:** Yeah, you don't have a system. You are saying, "Well, it just look like it was going to trend." Well, what elements of it looking like it was going to be a trend was there and why can't you define them?

If you can't define them then you're basically saying that you just had an emotion and you acted on that emotion. We know that, that's not a good way for humans to make rational decisions. It's like there's a book of books in it out there. It's very hard to find evidence that that's a good way to make good decisions.

**Walter:** I totally agree and I'll never forget the one time we had a bunch of traders on a webinar. I said, "Let's look at the M1 Euro" and I said, "I want to get a consensus here. When everyone agrees that this chart is going in one direction and that we're ready to take a trade, let's do it."

And so the little M1 candles were ticking up, up, up and everyone is okay, the uptrend is on. Damn it if that thing didn't turn around right there. It was just too obvious. It was amazing.

**Darren:** So, going back to the original question.

**Walter:** Yeah, so we talked about compounding. We're getting impatient. We're focusing in on results here and feeling like one really really freeing thing to do if your goal s to get out of your job, is to have enough money sitting. Just try to be frugal for awhile and save some money up so that you do not have that pressure to trade.

For example, let's say, I've got a job and I want to quit my job. Well what if I can just make a 3-year plan. I know, it sound "3 year, really that was so long". What if I can just have these goals that every 3 months, every 6 months, every year, I want to get my trading account to a certain level. See if I can do that.

Just see if am I maintaining monthly and quarterly making money. I'm compounding that and at the same time, saving in a way. What you want to do is to have enough money so that when you quit your job, even if you're trading totally goes in the can, you have that screw-you-money where you could just say, "Screw you. I've got money. I can live for nine months" or whatever, you know what I mean?

It's really empowering to have that and to be able to say, "I've got screw-you-money. I don't have to take a trade. I don't have to make money this month" or whatever. That sort of thing where you don't actually have to pull money out of your trading account. I think that takes the mental weight off of it.

The other thing that you could do is prove it to yourself as a trader that your trading account makes more than your salary for x number of months. Again it might take some time to build it up, compound it and get to that point and then you'll go, "Well, this account is now pulling in every quarter, every month, every year" whatever it is, you'll go, "This is pulling in more than actually I am making in my job".

So, that's another way to do it. People think, "That's so crazy. That's so far away." Not really. If you run the numbers and **I'll put the spreadsheet in the show notes** for everybody. You can download that and have a look. You will be amazed on how the compounding works. It's like a magic thing.

You just have to give it enough time like Darren said and then you will see it. The curve, it's like this very steep curve, the farther on you go down in time, it's one of those -- I don't know what it's called -- like parabolic or whatever, it's really sharp. It's not a 45 degree angle line. It's parabolic and so it gets really, really sharp at the end there. What you basically need are enough trades so that's the other thing.

Let's say that Darren trades his system and it's making 5 or 6% a month, is there any way that you can add a complementary system? Or the second, probably my least favorite thing would be to add more markets.

It's better I think, to add more systems than markets because once you start adding more markets, you can get into trouble with correlated results and that could be really tricky. Psychologically to deal with a drawdown in both accounts. That is another thing to keep in mind.

The shortcut for compounding is more trades. It's not taking more risks. Taking more risks will send you to a steeper valley and once you get down to that valley, people freak out and that is where they make the big mistakes.

So I think, building up a little nest egg of money, trying to setting up yourself goals but again like Darren said, it's really really important to look at this way. You have a

profitable trading system, you know that the system is profitable. The only thing that is going to break it is if it just stops working. What would happen if you just focus on the execution of that strategy? Not with an untoward results. What would happen like logically what is going to happen?

If you focus on just executing that strategy over the next 2,000 trades ,what is going to happen? The most likely thing that is going to happen is that the system is going to make money. If you don't take the money out of the account, and you keep risking the same percentage, the fixed fractional method then you are going to build that account. It will compound. It will get bigger and bigger, that's what will happen.

The only thing that could happen is one, you don't execute the strategy as you should or two, the system totally falls apart. That's really it. I mean, the most likely thing that's going to happen is it's just going to keep chugging along.

**Darren:** And I think, work on expectation. I talked about it a lot. Write down what your expectations are and see if they are reasonable. If you must focus on the outcome and how much money you're going to be then base that on reasonable expectations.

Study and read stuff from people who've been around for 20 or 30 years and made a lot of money. Consider how and what their journey has been like. Did they all make it on their first year? Have they grinded their way and done the same thing for 10 or 20 years and that's where they've amassed their shoots well.

Perhaps we spent a little bit too much time on public forums and kind of get caught up in the hyper of those little bit too much. I'd say, stop looking at them. Find people who've been trading for 10 or 20 years and made a lot of money.

A lot of them are out there sharing their story and you'll find that they were grinders. They had setbacks. They had years when they didn't make money but they've had a long term view and that's where their real profits have come from.

**Walter:** It's amazing how the people who stick with it end up doing alright. It's the people that quit, that fall by their ways, it's almost as if you do it long enough, you'll eventually figure it out. I really believe that.

It takes some people longer than others -- I'll raise my hand there -- and forward a bit years that I was just but I was like, there was no doubt in my mind. I mean, think about that, 4 years I was thinking and in the 4th year, I was still thinking, "This is going to work. This is going to work".

It was discouraging but if you'll talk to some of the older traders, you'll hear the same stories. They just knew that, that is what they're going to do. They didn't have any fallback options. They were totally going to do it.

It's amazing to me when you have that approach, how easier it is to keep the faith. Keep your eye on the goal. Keep your focus. It is discouraging. It stinks sometimes but it's also liberating when you just know it's going to happen. Like, you know you're going to make it work.

Some people, they're trading forex this year. Next year they're flipping real estate. Another year, they're riding the bitcoin wave or whatever. They're always kind of doing something different and that's cool.

I get it. They are looking for opportunities but the people that are in trading, who like you say, have been trading for a long time, we've all been through tough times. It's just that we've kind of stuck with it and I really do believe that if you stick with it, you will work it out. It's going to happen. It's going to work.

**Darren:** Yeah, definitely. I read this week that trading is very similar to dieting and there is no correct diet. It's the one that you'll stick to that is the diet for you. Again, it's human nature not to want it.

I think also nowadays, it's much harder to stick -- I don't know if it's harder to stick -- to long term plans now than it used to be but certainly most of our cultures set up around instant gratification. We want everything instantly.

Computers get faster, they still seem slow. Computer today, you think of the computer, they used to fly to the moon. NASA used to fly it to the moon. I think now you can get it in a watch but computers still seem slow today because the return effect diminishes to you.

So, that long term view is really hard for human beings to get onboard with but the important part of that is, you are trying to be in the top 5%. So you've got to ask yourself, "What is it about what I am doing is going to make me different to a 95%? Where am I going to find my edge?"

It's in things like that, being able to stick in things for a long term. Being able to hold on to trades longer. You've got to think, "What are the most common failings for traders? That is where I'm going to find my edge because I'm going to put systems in place so I'm not making those mistakes".

**Walter:** Absolutely. I definitely agree with that. We have another question here for you, Darren. Ready for number two? So, the question is: If I'll lose on the trade, did I do something wrong?

The prompt for this is I read a trading book once where one of the trader said and I find this really fascinating because I never really thought of it this way but he said, "If I take a trade and I lose on that trade, I believe the market was trying to teach me a lesson."

I have to say, I definitely didn't agree with that. I definitely do not agree with that. So, I'm wondering what are your thoughts are on that?

**Darren:** Well, you could've made a mistake but...

**Walter:** It's possible but his point was every losing trade that he has, -- assuming of course perfect execution, the reason why he lost -- we'll take out the execution part of it which I know is he big part but he's basically saying the market is teaching me a lesson that I'm supposed to learn but if I go back, I should have done something and if I hadn't done that thing, that would have been a loser.

To me I thought, "Wow," I've never even consider it. It kind of opened my mind to possibility but still I don't believe it.

**Darren:** Yeah, it's almost like they have a belief that if they've got the right skills then they're never going to lose.

**Walter:** Yeah, they're kind of saying that, isn't it? In kind of the reverse way.

**Darren:** Yeah, it's like what they hate the most is, you just don't know how to read the market. This idea that if you had the skill then you would've taken that lost which a lot of people hold onto but I don't find many traders who've been around for a very long time that have anything like that sort of belief. In fact, it tends to be the opposite really.

Whereas, they're kind of more surprised when they've got a winner than when they've got a loser. They're almost expecting it to be a loser. When it works out, it is right. That's nice, luck was on my side that time.

**Walter:** Absolutely. I know that thought. When you're trading for big wins, definitely you've got to get comfortable on that area. Like I was, I've ever thinking this week. I've only had this one trade but I took it and I thought, "Man, that stop loss is so tight. I'm definitely going to be popped out. I'm going to wake in up in the morning and find that I'm popped out" and it didn't. I said, "Wow".

It was like, you were saying expectations before about setting expectations and I'm reminded of, Denmark usually comes out as one of the happiest country if not as the happiest country in the world. They say the key is that they set their expectations low.

I guess trading is the same way. You just set your expectation low. Expect it to be a loser, calculate it to be a loser. Look at it like "Okay, I'll lose that money in the morning when I wake up".

**Darren:** Yeah and when I have a setup for trade, 99% of them feel wrong to me in the moment they feel wrong to me. That's why I have a system because my emotions are reacting to small incomplete bits of data. We haven't got all of the data when we enter a trade. Deep down inside we know that and that is why you get that uncomfortable feeling by pulling the trigger because you know you haven't got all of the data.

So when you are operating in that sort of environment, you've got to expect some variants in the outcomes regardless of what your system is. If your system is 50% win rate, you can lose 5, 6, 7 or 8 in a trough and you have to be happy working in that environment. If you are not then you're going to get that feeling that when you lose, it was somehow your mistake.

**Walter:** To me, the way I see it, the "correct" answer for me is, if I lose on that trade then the only acceptable reason for that is bad luck. If that is not the reason, for the reason why that trade was a loser, then that means then that I'm the one at fault. We've got to talk, I've got to go to the Principal's office. That is the only acceptable reason for losing trade. It was bad luck.

You get kicked out over the weekend, bad luck. There's a surprise tweet or something, there's news release, news comes out hit your stop, bad luck. You've got a signal and the signal didn't work out, it's just bad luck. That should be the reason, I believe for losing trade.

I don't think that it's anything that we do wrong necessarily but if it is execution, if it is in the execution realm, then certainly it wouldn't be bad luck but then I would say that, "That's my fault". If I'm trading my system correctly as I should, the only reason why I have a losing trade is bad luck really.

**Darren:** So our strategy is that manage good and bad luck and make the most in periods where we've got good luck. Reducing risk and loses when we've got bad luck. That's a big part of our system.

**Walter:** That's right and that's why stop losses.

**Darren:** That's why trailing stop systems works so well because you can't define how far prices are going to travel but if you can stay in as long as possible then that's should give you an edge.

**Walter:** So if you can get more winners on the fat tails and fewer loser towards the fat tails using a stop loss then in theory, you've got that edge. Exactly right. Are you ready for the next question?

**Darren:** I think, a good thing to do as well with that is again, just journal it. Writing down what happened when you had losing trades and writing down what happens when you had winning trades.

**Walter:** Right. Do you find that, when you journal obviously you use a pen or a pencil, right?

**Darren:** I don't.

**Walter:** Oh, you type with a keyboard?

**Darren:** Yeah and just have threads where I just post every trade. I don't even go into a great detail. You don't necessarily have to go into great detail about the trade. Although, it's showing to help to talk about it. Write down how you're feeling at the time and how you're feeling afterwards but just having some sort of record to refer to is good because in your mind, you make up also BS.

**Walter:** It basically adds to the fact.

**Darren:** Yeah with hindsight bias.

**Walter:** My understanding from the research is that and the reason why I used, what I do is I'd fill up a book and I'll go buy another nice little journal book. I like getting ones that I like to look at but what I read was that it helps with remembering and learning and processing information rather than typing. Typing is a different process for your brain and I was just wondering if you had try both. If you could compare or whatever.

**Darren:** I can't but Dennis Shaw did a lot of research on this and definitely physically writing down builds stronger memories.

**Walter:** Yeah that's what they've found. The studies that I'd been able to dig up. Interesting. You wouldn't have like some traders they'll have like a library of ideal trades. So when they'll look at the trade on the chart, for example if they're using some sort of pattern, they can compare it to their ideal print out of that pattern and say, "Is this the same? If it's the same then I'll take it" but that's really not what you're doing, is it?

Yours is a bit more simple and could be argued more robust than that, isn't it? Because you are just waiting for that turning point. It doesn't really matter what it looks like. Could you trade the line chart? Would you be able to trade just the line chart without candles or would it have to be candle chart?

**Darren:** Yeah, definitely. I could trade the line chart. I had a sort of a debate about this yesterday and about time frames. A lot depends on where your edge comes from. Your edge might come forth from a particular pattern of candles. That might be your edge, you might find an edge in that but mine definitely doesn't. So it is about knowing what element of your strategy is giving you the most edge and explored in that.

**Walter:** That's all the time we have for this episode but in Part Two, you're going to hear about what big market data tells us about the markets. Why traders have this obsession with the wrong thing and what we should be looking at instead. The one magic fix for all trading systems.

I know it sounds crazy but if you do this, you'll generally going to be alright with your trading. Why traders are obsessed with the normal curve and here's a hint: It shows up everywhere even where it shouldn't be. And, the genius of the low IQ trader. Great lessons for all traders.

All this and more in Part Two of the Two Traders Podcast. See you then!