
# EP85: Trading Squid

**Walter:** I've noticed that, typically, most traders will have their stop losses too close to entry and they will give their trades too much room when exiting...

**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 back to Two Traders. It's Walter here. I've got Darren on the line. Hello, Darren.

**Darren:** Good evening, Walter

**Walter:** We are going to talk about how natural is trading. I guess the question is why is it if the market only goes up and down that you just cannot flip a coin or throw a dart or watch a squid? Have you seen those things where they have the squid?

**Darren:** I have. Yeah.

**Walter:** Which team is going to win the World Cup and things like that. Have you seen that?

**Darren:** I have, yeah.

**Walter:** It's the famous squid, right? I forgot his name.

**Darren:** Was it a squid or is it an octopus? I think it's an octopus.

**Walter:** Maybe it's an octopus. I've got squid on the brain. My friend just went squid fishing, he was telling me about it. I think that is why I've got squid on the brain so this octopus was really accurate.

The question is why can't we do that with trading? Why is it that some traders will say, "Look, it can't be that difficult. It's either going to go up or going down?" How come everytime I took a trade, it's seems like I am on the wrong side? Why is that? Is there something about the markets that makes that more likely, Darren?

I guess that is my question because I've been thinking a lot about this. I think you can use this principle and others also agree but, what do you think about this? Why is it that it seems like each piece is so easy to pick aside and yet oftentimes the way that it works out for us is -- especially in the beginning when we first start trading -- it's almost like you should you should just reverse every decision you make?

**Darren:** Difficult one to decipher, really. I think you just can't flip a coin and pick the direction from that. I think it's the other elements that are important. Maybe it's the fact that we

are looking for something to go instantly in our direction that leads to all of the other mistakes which eventually means you feel like, like you say, it's like you are never winning such as having a stop too tight, moving the stop to breakeven too quickly and then closing out your winners before they reach their target. I think those simple things creep in because price doesn't necessarily always go in your direction.

I think really the problem lies in the ones that do go your way being affected by the fact that say many are not. I think also this idea that somehow your system and your analysis is going to tower you is going to time that the turn in the market.

When you sort of break it down and think about it, what a ridiculous thing to say, really. If you think about the complexity of the orders coming in and out of the market, you might be looking for the close of these one bar but to presume that everybody else is working on that basis, as well. With so many participants, it just seems a little bit far fetched for me.

I think we have this succession would be able to time the turning point, really. That is what most people are looking for. They want to get within however many pips, not too many of the point where price completely turn around.

We hang our hats on these simple things as basically telling us what the whole of the other market i thinking and doing and really that is ridiculous. You'll never going to get that right and if that is the case. You've got to look for your edge in something else. It can be as simple as letting trades run. I just think we are looking at the wrong places.

**Walter:** Right. So, like simple solution is, instead of trying to be right, you just when you're right maximize it like let your trade run. Something like that.

**Darren:** I think that is closer to it. I mean, I just cannot sit here and say, "Look, hold everything for 5:1 risk/reward and that's it nothing else matters." I am not going to say that. That sort of approach will have a greater effect on your results than focusing on trying to time the entry.

**Walter:** Yeah. I think the assumption in the question why is it that the market only goes up or down, I seem to be always on the wrong side. Shouldn't I be able to flip a coin and figure this out and make it work and be right half the time?

The assumption there is really tied to the question which is it's all about the entry. I've got to know which way to go. That's like what the question seems is that trading is about making this work, making profits. It's about finding the right entry and that may not be right.

I find that fascinating to watch the open position ratio. **I'll link this up in the shownotes for people who are interested or haven't seen it.** I use it as an additional tool to my trades where I look and say, "What are the retail traders doing?"

Every 20 minutes, I can get these data and it says this is how many for this broker and a lot of brokers will offer this information. It's not always updated every 20 minutes, might be daily or something, but what you can see is where are the other traders doing.

The reason why I want to know this is because I want to know where are the really tiny pockets/packets of traders trading and then I'll pull up that chart and say, "Okay, that makes a lot of sense to me".

For example, as we're recording this -- and I'll post the charts on the show notes so you guys can see -- but as we're recording this, I have a what I consider to be very bearish pattern on the EUR/CHF.

Now, when I go and look, I see right now as I'm looking at the numbers, it says that 70.6% of the traders who are trading the EUR/CHF as of this broker are buying and I've got a pending sell order.

So, what I want to happen is I want to be in that little group of 29% or 25% or whatever it is of traders who are going the other way. What I find fascinating is if you've watched these numbers -- let's say, for example the market is trending.

A lot of times what you'll see is if the market's just starting to go into a trend, you'll see a lot people trying to take it the other way. If it's just starting to go on a bullish trend, traders will be looking to sell, sell, sell.

What happens and what fuels that trend, my belief is that the market is just getting up there and reaching all those orders, all those stop loss up there for the traders who are going against the trend and it keeps clicking into those and keeps fueling the trend. At least in the beginning, that's really, really obvious when you look at these numbers.

The other thing is that if they're right, if the crowd is right, as soon as the market starts going into their favor, the numbers completely reversed. In other words, everyone is getting out of their trades really quickly. You know what I mean?

It's totally obvious. It's the funniest thing but you can see it on this. I think it's something that every trader should at least once have a look at and say, "Okay, what's going on here?"

**Darren:** Yeah. Even if you do not want to use it to trade, it is telling you the realities of the movement of price and how the majority of traders who are losing are playing it wrong. Getting out of there when it's too soon.

**Walter:** Actually, both of my trade -- through the 4 trades I'm in right now -- the only reason the other ones are not on this list because they're like exotics or whatever. They do not actually fall to the percentages.

My EUR/CHF trade hasn't been triggered but I've got the order in. I've got another trade on the AUD where I'm buying the AUD. Sixty point four percent traders are selling the AUD right now. You might not use it by itself but I feel good knowing that traders are using stop losses and hopefully their stop losses are fueling this move. That is my thinking.

The reason why I bring this up is because it highlights what we're talking about here where it's difficult. It seems like traders, when they see the market goes strong in one direction, most traders don't think. I've tested a lot of traders and I found this to be true.

About 70-80% of the traders, when the markets gets really strong in one direction, they're thinking, "Okay, I want to catch the reversal. Where is the reversal? I've got to get this reversal." That is what they are thinking.

They are thinking, "Okay, I want to ride this trend." That's the minority that thinks that so I find that pretty interesting too.

**Darren:** Yeah. It always appear like those trades come back and they give retrace. This is the whole point. You have to have some sort of process for allowing your winning trades to come back a bit and let them move on again. It moves in that up and down movement.

People want to enter a trade and they want it to go straight from point A to point B and it just never does that. You might get one crazy spike in a blue moon. Generally, it's going to meanders, spike up towards it, and it's going to retrace back, and then it's going to start climbing again.

You have to go through this whole process and I think traders -- not traders -- people have difficulty with that. They have difficulty seeing it through.

**Walter:** Yeah, absolutely. If I'm thinking about what you have just said in terms of the charts and the numbers, the open positions, I would say, "Alright, everyone is..." Let's say, for example, everyone is thinking that the GBP is going to turn around. The GBP is really going up really strongly.

The GBP is moving up and it looks like it's an uptrend if you'll look at the chart and you look at the numbers and 77% of the traders are shorting the GBP. There's a really small 23% of minority that's going long, that's going with the trend. Now, if you watch the numbers, what typically happen is as soon as it starts to retrace a bit, a lot of those traders will stop shorting the GBP or close their positions.

In other words, they're capturing these little retracement moves that you are talking about in the midst of a trend so they're taking a buyout of the little slice of the pie. Whereas, the minority, the trend traders, they are trying to take a buyout of the huge piece, the rest of the pie.

It's an easier thing to do in terms of the numbers but, psychologically, it's difficult to look at something and go, "Well, it's made a 51 week high. The GBP higher than has been the last 51 weeks. So, yeah, I think it's going to go farther" like that. Psychologically, I think for a lot of people, it's difficult to do that.

That gets back to our original question which is why is this so difficult? Why does it seem like every decision I make as a trader is the wrong one? Why is it that I feel like I know that it can only go up and down but I keep choosing the wrong side?

The other thing I will mention because I've noticed it too -- I think you might agree as well --is the way you trade. I've noticed that, typically, most traders will have their stop losses too close to entry and then they will give their trades too much room when exiting.

If you think about it, you get into a trade -- let's say have some sort of a trailing exit to get out. Typically, what happens is traders will want to have really, really tight stop on entry and they want to give it a lot of room on the exit.

They are more likely to get stopped out on the entry and they are more likely to give back too much on the exit because their trailing exit or whatever or their decision making is not as ... Because the way I look at it is when you take a trade, when you're looking at the charts and you're neutral, you do not have an open position.

You look at the chart, you decide is there anything going on here? If you say yeah, you take a trade. Now, you've immediately gone from neutral observer. Let's say you buy the GBP, you see the chart, you say, "Yeah, it's enough trade. I am going to buy the GBP".

So, now you should be looking to essentially defend that trade. It is like when you are playing basketball, when your team has the ball, you try to score. As soon as you lose the ball, the other teams has it and you go straight onto defense.

It is the same thing here with trading where when you're in a trade, everything has to be about, "Okay, when do I exit? How do I exit? Is there an exit signal?" instead of thinking, "Oh! It'll be great if this trade would really off 700 pips over the next 2 weeks".
You need to think where is the exit signal? How do I get out of this? It's all about the defense. Protect your account when you move to breakeven. When do you take profit? I know it's easy that if you wait long enough you're going to make those 800 pips but you also have to be realistic in terms of how many of those 800 pip trades am I going to get each month and if this is not one of those 800 pip trades, when do I know to get out?

That is really what I think where the focus needs to be because traders have the opposites. They each have a wider stop -- which I believe you say the way that you trade -- with that wider stop and quick to get out. I do not know. Is that how you trade?

**Darren:** Yeah. Initial wider stop and then not moving the stop up too soon, I think those are two elements. When there is a large profit and then you need to be more tighter with your trailing stop.

Those 3 elements, if you can get a combination of them working for you and you can stick with it over the long run, I think that is the buildings of a something with a real edge. I really think if you get those 3 right, the importance of the entry becomes much less important to the point where you can almost take a random trade.

**Walter:** If I understand you correctly, Darren, you are essentially saying if you boil it down to three important elements for your trading, you believe that if most traders would give themselves a little bit more wider stop in the beginning at least when they first enter the trade and if they are little bit more patient when they are moving their stop.

So, moving to less risk or break even or whatever, you wait for that trade to mature, pull back and then go in your favor and then finally, when you do have a nice big, fat profit on that trade that you really tighten up your exit and make sure that you don't give it too much room to bounce around and give that too much profit. Is that essentially what you're saying?

**Darren:** Yes, that's it. We basically get those three elements wrong and if you can get those three elements right, I think it can give you much more scope for different source of entries working for you.

I understand it's really hard to do. Definitely, those three elements are wider initial stop. Not moving your stop to breakeven too soon and then when you get closer to your bull park take profit -- whether it be 3 to 1 or whatever -- and then you've moved to a much tighter trailing stop.

If you consider the way the price moves in this up and down, zig zaggy way then that is a logical way to approach the market.

**Walter:** I often wonder if it's true that most traders have too many stops and are too tight which I do believe that's the case as what I've seen. That is a contributing factor with their win rate.

The reason why they have such a poor win rate is because they are not giving the market enough room and they're getting stopped out almost from the get-go. Even if they were right, they're really not giving themselves a chance.

The other thing you say about moving to breakeven -- this is something that I've really struggle with because I am okay with the idea that I took a trade that didn't really happen if I get stopped out at breakeven so, I feel like I'll move to breakeven to try and defend. Like, let's say I have a target. If the market goes 70% to the way of my target, I would typically move to breakeven. It still hasn't reached my target but I'll defend it.

I don't want it to be looser now. I feel like I've been right at least in this instance and I do not want to be giving money back to the market because I was too stubborn to leave my stop and let it and decide, "Oh! Let's see what it does. Will it hit my target or will it hit my stop?"

I feel like having that part of my sleeve, being able to use the breakeven card is important to me. Sometimes, I feel like I do it a little bit too quickly but what I am trying to do is... I guess, what I'm trying to say is I am trying to train my mind to think of it a breakeven trade. A trade that's never happened rather than a winning trade that I lost down on, if that makes any sense.

What do you look for? Do you look for that initial pull back before you move to breakeven? How do you do that?

**Darren:** I think moving to breakeven is not something that I really use. It appears to me that everyone seems to like 1:1 risk/reward. This seems to be the most popular level to move to breakeven.

So, you're risking 50 pips when it gets to 50 pips, people seem to like that level as their move to breakeven. I would suggest that perhaps letting it go a bit farther. You have to look at other elements like trade frequency. If your system only generates one or two trades a week, then maybe you are best suited to letting more of the trades run.

Those other elements need to be taken into account and I think it's dangerous to say that at 1.5 risk to reward move to breakeven, then you'll be fine. You need to play with

those figures but bear in mind that you're never going to find the perfect, you're going to find something that works.

That is why you should really be aiming for something that really works and something that is consistent.

**Walter:** Yeah, absolutely. The reason why there's a lot of wiggle room here is because everyone is different. For most people, the most painful trade to deal with is the amazing winner that they've missed out on.

The other one that's really painful -- let's say perhaps more painful -- is that amazing loser that you kept adding to or kept moving to stop or made it into a huge loser. Those two thing that you have to deal with are really difficult to traders. Getting a huge loss and missing on a huge win, those two are just terrible.

Based on those, you have to decide. To me, it's more important to if I have a trade where I'm in a trade and the markets gone in my favor, I would say substantially if it's gone 70% out of the way to my target, it's more important for me to defend my account and not lose money at this point than fro me to click out and take the 70% or ensure that I have some profit here

I want to keep where the target is because it was set there for a reason in terms of making sure that I am not taking my profits too quickly which is the real killer. To me, that is the most important thing.

I just want to defend the account. Let's not give in and bleed any money here if we can. Other traders are not going to look at it like that. They're going to say, for example, maybe you really have a wide 120 pips stop and the market goes 60-70% on the way to your target and you take that 120 pips stop and you move to 60 pips. That's another thing you can do.

You've reduced your risk in half even though you are not at break even. You are still giving it some room. Those are the sort of things that makes sense to me. It just depends on what's the most important thing to you as a trader, I suppose.

**Darren:** I like that, as well. I like that because you'll find that most people are not doing that. 1:1 risk/reward. Most people are moving to break even so I'd say, "Okay, let's have a look and just take in half the risk off. Let's look at that. Let's just try to slightly to be different. Let's try and be contrarian to what everybody is doing."

I think those are the hilarious where you're going to find something that is going to start your trading clicking for you.

**Walter:** Yeah. And you can also look at that style of stop management when you add to winners too. That is something for listeners to test. You've got this idea that we've just talked about which is instead of moving straight to breakeven, all or none, there are percentages too that you can manage.

Those interplay with adding to winners and things like that so that you can maintain a risk level that's acceptable and still have the potential profit if it goes or keeps going to your favor.

Those are lots of fruit flares for research for people who are into this stuff. I guess we have really solved the mystery of the universe, Darren. Why trading is so difficult?

**Darren:** I would say, as well, going back to the original point of the question of the podcast where I imagine a lot of the traders who feel that price is always going against them. It's probably just going against them 50% of the time but that feels like all of the time.

I think, again, you've got to be really clear on your detour and journaling so you can really work out what exactly is going on. Where am I losing money? Which things are working for me and which are not?

Our assumptions, more often than not, are really way off on this. No matter how smart you think you are, you really cannot see the wood for the trees sometimes unless you start making notes ands planning out, working out what exactly is going on.

**Walter:** That's good stuff. Hope that you guys are able to get, giving you few tools here, different ways of managing your stops and your exits. You can see what the crowd is doing with the retail traders.

I'll put those links in the shownotes and you can manage your trades in a different way to the way that everyone else's is doing and that might actually help you. I feel like it's also so unnatural trading.

It's such a thing that it's not just something that makes sense to people. I think we tend to... I really do not want to say follow the crowd because I really don't think it is following the crowd so much as everyone is sort of wired a certain way and that comes through in the market.

**Darren:** It's in theory, as well. Does it really go away? You have this belief that "Oh yeah, when I get there, brilliant because it's going to release doubts and feelings and it's annoying trading and you can never really..." Well, for me personally that really never goes away.

That is why we find it so difficult. It is not natural.

**Walter:** Absolutely. It's not natural. You've got to teach yourself to do it in a way that is unnatural essentially. That's right. Well, thanks, Darren. Looking forward to seeing you next time. Thanks for your time.

**Darren:** Thanks, Walter.