EP98: The Secret to Trading

Darren: And there's a danger there, you've got to find the balance between trading something that suits your personality and just trading something because it feels easy to you...

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 Two Traders. It's Walter here. Hi, Darren how are you?

Darren: I'm very good, Walter. Nice to speak to you again.

Walter: Yeah, great to hear from you. So, Darren, I have this idea. The idea goes something like this and I'd love to get your thoughts on it.

It is that there is this so-called "Secret to Trading," right? It always sounds better when you say "secret". The idea is that, like an airplane or an airline flight, that really tricky part. If you'll talk to any pilot, they'll tell you the really tricky and dangerous parts are when they take off and when they land.

In the middle, it's usually not that big of a deal. In fact, with the modern airlines, the pilots don't really do much. It's almost completely on autopilot for most of the flight, which a lot of people don't know.

So, taking that analogy across to trading and you say, is it true that if you can just navigate the take-off and you can just work your way through the landing, that the middle part of your trade is actually, there isn't really much to do there or at a minimum, it's the easiest part of the journey when you look at your trade this way?

So, I'd love to get your thoughts on these whether you agree or disagree or if you think it's a little bit off but I thought it's a really interesting analogy.

Darren: Yeah. It's really difficult to pin down the important parts of trading in that respect, I think. You could argue that there are key decisions that are important and then there are other elements which are really out of your control anyway and your decisions are not going to make much difference.

I think those elements might be saying something like let's say, the discretionary part of your exit where you have to use some analysis and decide whether let's say,you've reached TP1 and you need to make -- your system says at this point -- you make a decision whether you go for TP2 or you close a trade or close a part of it.

Those kind of decisions that are based purely on analysis, you could say that they are like the middle part of the flight, really. Over the long run, there's going to be a lot of

luck involved in those decisions and you don't really have that much control over the outcome.

And, I supposed then, you could say that the important decisions like the take-off and landing, would be those elements that keep you in line with the part of your strategy that creates the edge.

So, let's say for instance, making sure you hold your trades to the correct TP and not closing them early and likewise with closing out your losing trades. I think, in that respective idea, that there are important decisions that will have control, will have a determining effect on your results over the long time.

And then there's others where you don't really want to beat yourself up about it because of what happens next. You don't know and essentially you need to pick A or B. You can't really determine and you can't really always be right on those elements. So from that point of view, I think yeah, there's similarities.

Walter: Right. So, the way I look at it is I was thinking about this and I thought well, for some traders, you might argue that the take off and the landing are almost blended into the same thing. They are not quite but almost the same decision.

In other words, at some stage for some traders, what happens is they're in the trade and the decision to take off --or the beginning part of the trade which is basically when you place the trade and when you place your order, you get in your trade, you pull the trigger and you're in.

At some stage, that switches over to... It shifts to managing the exit, right? And, you could argue that as soon as you're in the trade really, you've gone to exit mode. How do I manage this, getting out of this trade? I mean, you could argu that's the best way to approach your trade. Do you know what I mean?

Darren: Yeah, I suppose I am. I think really a lot of trading strategies will have or already have a determined place where they get out of the trade so, essentially, from the entry to the exit, there's not really anything you can do.

It's unusual for a strategy to have, then do more analysis as time goes on. Essentially, really you should step away from the computer then unless, you have a strategy that says you have an ongoing analysis and that's where you decide on your exit point. I'm not convinced that's particularly a good way to go about it, though.

Walter: Yeah, right. I'm with you. So, let's say... Okay, let's take this hypothetical trader. He has a system where let's say, he's like a breakout strategy and he doesn't watch the market during the Asian Session and soon as the London market opens, he looks to take a trade.

He's looking to capitalize on the volume floods in the early European market and so our trader buddy he uses a trailing exit. What he does is he just waits for the market to go and he doesn't have a TP, doesn't have a target in mind at all.

All he is doing is he's managing his trade and let's say, for example, he takes a trade today and the market breaks out of the Asian Box, so to speak, and trades higher so he goes long the GBP.

In this case, the GBP against the USD, and he's long and all he has to do now is manage his exit. His trailing exit is to simply trail and put a stop loss. His stop loss just meant to trail underneath of all the little local lows.

Like, Bill Williams would call that a "fracto" or whatever. It's basically like a little low. Every time the market makes a new low, he just moves to his trailing exit up and locks in more profit until he gets stopped out.

In that case, to me -- maybe I am looking at it differently to the way you would -- but in that case, all he's really doing from the moment that he takes off as soon as the trade is triggered. All he's really doing is managing the landing of that trade.

He's doing that by simply trailing his exit manually, right? Waiting for this little lows to be made and he's hoping that they're higher lows and once in awhile he's really happy because he has this amazing trade.

Where a lot time, he gets stopped out with the small or medium sized win and he obviously takes his share of losers as well.

Darren: I supposed in that example, the part where he's essentially in the middle of flight would be say price raised much higher really quickly, he wouldn't then change his landed part of trailing his stop just because something slightly unexpected happened.

He'd essentially just that bit would be on autopilot and he would ignore anything else that happened.

Walter: Yeah and he would hope that there'll be another local low that's made up, way up there, up higher so that he can lock in more profit. Exactly.

Darren: It's like there's this certain elements of trading strategy that should be adhered to because over the long run. It's those elements that make us profitable and regardless of what happens in between. As long as we take care of the take off and the landing then we should be alright and the danger comes in when we start then considering other elements to be important in the moment.

Walter: Yeah, and I think they creep in, don't they? You can think of things like for example, I had a trade on and it was on the GBP/JPY,. It was during the day of the UK elections. Normally -- now it's over there in London -- what happens is in the evening time over in London is the Asian session -- and there's no whole lot of action -- but what happened was I got slipped on my trade. I got stopped out and I lost a lot more than I calculated because of the slippage on that GBP/JPY trade.

It was a loser and a bad loser but things like that happening when you're in a trade can make you reconsidering and go, "Oh, next time I'll do this" or whatever and that's how I think mistakes are made. You know what I mean?

I don't know that it's necessarily the case that it's so always so automatic during the middle part of the trade because I could see where... Like for your example, like you're saying, the market takes off and then, what does our trader do?

Does he just decide, "Well, it's gone up a 100 pips but it hasn't allowed me to move my stop loss so am I really going to give it a 120 pips of cushion here or should I move it half way up and take another 60 pip profit here in case I do get stopped out? How do I deal with that?" I think that is a good point.

I mean, unless you have it fully automated like a trailing exit, fully automated where you don't have to manage it, it's hard not to have things like that sneak in. It's hard for me to go back and take another trade when there's impending news or whatever knowing that the last time I did that the market fell because they say, "Well, we don't know what the election results are going to be." So, the GBP really fell off the cliff that evening, during the Asian session or less.

So, there's these things that are happening in trading that make you think that you need to add rules. I don't necessarily think that's the case but I think that it goes against this idea that we're talking about here or introduce which is the middle part of the trade is the easy part and maybe that is not the case.

Darren: Yeah. The interesting thing when we compare it to flying is that pilots have had lots of training and lots of experience. They still do have checklists of the important elements that have to be done every time they take off, every time they prepare for landing, and they do not fly the flight as well.

So, obviously, it's something in us as humans to kind of not find it easy to stick to this simple processes and they deemed it necessary that when flying a plane. You may have been flying a plane for 10, 20 years or whatever and you know the process to go for but you're still are going to have a checklist there to make sure that you get the important elements right each time you fly.

I supposed I mean those elements are not going to protect you from everything that can go wrong but they deemed it as the important elements. I think you need to that for your strategy. You need to breakdown and find out what is the core reason that your strategy makes profit over the long run?

You need to make sure that those elements are protected and also it's important to realize that there's element to your strategy that although they might feel important, they don't really make a great deal of a difference to your profit over the long run.

Those are the things that we slip in as kind of curve fitting. They have like one particularly bad running period and you decide to try and tweak your rules so that that doesn't happen again.

Those rules will feel be significant as well but over the long run if you would've just taken that losing period for what it was, bad luck or bad market conditions, then you might not make those changes to your rules and you're likely to have made more profit over the long period.

Walter: Yeah. So, how do you know? I guess, for the trader listening, how does the trader know when they're curve fitting? How can you tell? What's the test?

Darren: It's very difficult to know for sure but, generally, curve fitting rules will improve your performance over a small sample. If you stretch out over a larger sample, if it's still making a positive effect, then you're not curve fitting. But, if it's only significant in a small sample then, that's just probably luck and curve fitting as well that's going on. That is how I see it, anyway.

Walter: Yeah, that's how the algo guys approach it too. They'll use different samples and stuff when they're testing which you can do that as a discretionary trader too if you're running a forex tester or whatever.

Darren: Yeah. I mean because you don't want a strategy that made 10% last week but over the year lost or blew up your account. You'll want something that made a profit over the whole year and it didn't matter if you lost money last week.

That's essentially what we are all looking for, unless you're just looking to double your account in one week and stop trading which I don't believe we're in.

Walter: Exactly. I think for me, one of the things we can say that it's not as smooth sailing as it seems at first glance. Like the middle part of the trade can become tricky and I also think that we've talked about this before. We're built to lose money.

The average person, the vast majority, the huge majority of people who participate in the markets are built to lose money and so that's not a slight against you, or me or anyone listening to this. It's just the way we're built. That's the psychology and so when you have this brilliant light bulb moment and you think, "Okay, this has been what's happening to me so I need to add this component to my trading system." That's like the road to hell is paid for the good intentions. That's like the sign that, to me, that's how I see it so I think, few moving parts, the simpler the better. All those things move you farther and farther away from curve fitting.

The problem is some people think it's too simple, that there's no way that something like that can work. I've heard of systems where that's like literally people buy the market at 05:05 pm everyday and that's the system.

It's like really this simple systems that have been developed and there's no way that it can work. You didn't even take an account the trend. You just buy everyday at 05:05 pm or whatever. Those things like that but, to me, makes sense that they would work because everyone is looking for the more complex and they're all adding more elements to their system and I think that's why I want to get farther and farther away from that all.

I don't want to do what the crowd is doing, I guess. I know you're the same way, really.

Darren: Yeah. I mean, we have to appreciate that traders, in general, are highly skilled now and highly educated. We all have access to the same information, essentially. It's not like it was a long time ago when information where just there for the wealthiest.

With the internet now, we can all access that information. We can all gain the knowledge that is all there to gain. The amount of skill in the market is much higher and so you need to have something slightly different that is going to give you the edge.

If you just believe that somehow you have some sort of particular skill or ability that the majority of traders don't have then, you're going to be disappointed because there's a lot of skill people out there trying to make money and at the same time you are.

So, you need to have some sort of plan and move to different approach to attack the market and if you'll look at how you're trading, then essentially, it aligns with what everybody else is doing but you still believe that you're going to be successful even though they're not.

You've got to ask yourself why that is and if you're honest with yourself, you could realize that you need to do something different. If everyone is closing out their trades early and everyone is letting their winners, their losers, run against them then you need to make sure that you're not in that group. Do you see what I mean?

Walter: Yeah. And, if everyone is looking at that really strong move up and thinking, "Okay, I'm going to find a reversal point," then maybe you need to just assume that it's going to go up. Right?

Darren: Yeah. Generally, when you look at the retail crowd, we tend to lean towards smaller risk to reward. They tend to be -- going back to your point about it's not natural being traders -- we all tend to lean to what feels more comfortable and what feels right and what we can deal with.

This is part of the problem with the notion that you need to find out what sort of personality you are and trade in a style that suits your personality. Although, I'm 100% agreeing of that, what you need to be wary of is just picking all of the things that feel nice because you tend to do that with trading.

You'll look at the trading system, you'll start testing it, and you think, "I just don't like letting my winners run so I'm going to go for a smaller profit target on this and use the same system."

You'll find that you tend to that with all of the elements in the belief that you're making the strategy work with your personality but, a lot of the time, what you're doing is you're just removing all of the elements that feel uncomfortable to you.

I really strongly believe that the best trading strategies will suit your personality but there's still elements there that feel uncomfortable. You better find a way of dealing with those feelings and emotions of being anxious or uncomfortable -- or you could even say it's painful.

You better find processes to deal with that than trying to just remove all of those elements and there's a danger there. You've got to find the balance between trading something that suits your personality and just trading something because it feels easy to you.

Walter: Yup. And, I think that would make a very good episode actually to talk about those comfort level, where it comes from, and where exactly you need to challenge yourself. That is something that I've been thinking about and I really think that would make a good episode.

Okay. Well, thanks for your time, Darren. We'll see you next time.

Darren: Cool. See you next time, Walter.