2 TRADERS

[EP10: Random Entry Systems?](#)

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Walter: When you start taking profits early, you are literally increasing the odds that you will fail as a trader and People just don't get that.....

Announcer: 2 Traders, Darren and Walter pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the 2 Traders Podcast.

Walter: Hey there. Walter here from the 2 Traders Podcast. Today Darren and I take a look at taking a break. What does holiday time do for your trading? We also look at why Darren uses technical training tools, even though he believes they provide no edge for his trading. We also examine the random walk trading method and the surprising results that this style of trading will probably yield. A critical look at the Saint Christopher Medal, and what that has to do with trading. We also look at my favorite trader interview, and it's not in the Market Wizards trading book. Darren floats his theory about the opposite signal test that he uses before he ever examines a trading system in seriousness. I've got a theory about the first girlfriend and trading exits, and we tackle this in today's session. Darren and I also look at why you need to decide which trading camp you are in, and why this is so critical to your trading. You will see why I split my exits with my trading setups. We also jump into the haunted mansion, and the timed stop. Finally, Darren and I go into the most common trading mistake that kills many traders' chances of making consistent profits. All this and more in today's episode.

Welcome back, Darren. You've had a refreshing holiday, I understand?

Darren: Yeah. It's been a really good break and nearly a month off trading. Like we were chatting before, it's been really good to have that complete break from trading. Like I said, I've been thinking about it whilst I've been away. Whenever I come back, I always kind of have a little bit of an adjustment with what I was doing before as well. I kind of feel like I've got some sort of fresh ideas. It's not new strategies as such, but just sort of a fresher way of thinking about my trading. That's been really good.

Walter: It's not a mechanical thing. Is it more of a psychological thing, or how is your approach evolving?

Darren: I've always got this slight inner turmoil with my trading, because I use technical things like support, and resistance, and price action, but at the same time, I don't believe they offer any edge to my trading. It's just kind of ... I'm forever sort of trying to resolve that in my head and trying to sort of condense trading trying to sort of a one line idea, and make it really almost like ... It's like an eloquent equation that's this really simple, and this is the process, if you like. I always have trouble with that, and it's kind of become a bit clearer for me having that break. It always does when I have a break.

Walter: Here is something that I've thought a lot and I've tested it, this idea of the sort of the random walk trading account. Let me ask you this. If you had an account where you just flipped a coin or any sort of roll a die, any sort of random thing to get into a trade, decide whether to buy or sell, and you set up your exits so that it was 5:1, 6:1, 7:1. You are risking 100 pips to make 700 pips, for example. Do you think that you would make money on that trading account?

Darren: Yeah, I'd make a lot of money.

Walter: I think you're right.

Darren: I've seen data that agrees with that notion as well.

Walter: This is one thing that I've helped traders who are kind of getting through blocks to see is that you should be focusing on your exit. You should be focusing on more than that, your exit, in relation to your stop. I know you are a big proponent of having these huge wide stops. I guess some people would say the same about me, really. I guess one of the things that you learn when you do this exercise, whether it's on a demo account, or even just a small account, just to test it out for yourself, is you learn that it's humming and highing over the reason why they get into a trade. Trying to refine that process is like almost energy pissed down the drain. It's not worth it.

Darren: I think it's the mindset you hold about those reasons as well. I use support and resistance in my trading, but if I don't believe it, it doesn't matter. It's why do I use it. I use those technical elements to define a method. It means that I haven't got that full going around in my head, why should this work? Why won't it work? I know the method is there to stop me behaving badly, if you like. I wait for certain conditions to be met, that's a valid trade and I take the trade, but I know it's not those conditions that are going to likely make the trade win. It's not going to predict the outcome of my trade, but it just means that I can perform correctly. If I'm having a bad day, I won't just go crazy and just ..... to random trade zone, because I have this kind of method I follow each day, and that kind of keeps me ordered. It's for those reasons I use the technical elements.

Walter: Right. For some reason, I keep thinking of the old Catholic lady on the plane who has the Saint Christopher Medal, which to Saint Christopher, if you don't know, is this patron saint of travelers, I believe. She feels really nervous getting on the plane and she's taking off, but because she has this medal, it almost calms her down and makes her feel like she's protected and that her travels are going to end well and everything is going to be safe. She is not running around the plane going crazy, because she's got the Saint Christopher Medal. Is that a good analogy, or is that a bit off?

Darren: Yeah, because I'm sure ... Maybe not in this instance, but generally if you think rationally about those things, you know it's not really going to change the outcome of your flight on that plane, but it's comforting as human beings to have something to believe in. That's exactly what I do with my trading. I use these technical elements, and I believe the method is good, but at the same time, I know those on their own are not enough. It's other elements that are going to decide whether I'm profitable or not.

Walter: Yeah, exactly. Let me ask you this, because this is one of the ... I think I mention this interview all the time. I think this guy is brilliant. There was an interview of this guy in the book called "Every-day Traders" by Nick Radge, and this trader who ... It's actually on my bookshelf. I'll pull it off. I forgot his name, but I'll mention it here today. He outsourced his trading decisions, and his whole deal was just to manage the trade and go for a 3:1 reward to risk ratio. He would subscribe to this Forex ... He was a Forex trader, and he would subscribe to this Forex signals. He ran a fund this way. All he would do with his fund is take the signals that the so-called-experts would rattle off and his job was to put it at 3:1. He said, "Look. I would only take a loss, or I would take a 300% win, and that's all I ever do." The reason why he did it was very specific. He thought that it was a good idea to outsource the reasons for his trading and not have that as his own burden. He didn't have to feel like he had to tweak his trading system, because he had nothing to do with it. He was just implementing the signals that were given to him. I thought there was some brilliance there. I guess my question for you would be, given what you believe about the reasons why you take trades and the structure, would that work for you? Could you do something like that?

Darren: Yeah. He's obviously kind of married to that idea of that's how he's going to decide his entries, but he knows that it's really the fact that his winners are significantly bigger than his losers. That means that he makes profit. We are essentially doing the same thing. I look at those kind of concepts all the time. The one that strikes me or the one that I do is, when I look at a system, I think about if it works using say a certain signal is a buy, and I use say a 3:1 risk to reward, if that tests well and works, then in theory, it should work as well if I take the opposite position from the same signal but still use a 3:1 risk to reward. In other words, a signal that is normally a buy for me do sales at those positions, and then it should still work in theory. Does that sound totally crazy?

Walter: On the surface it does, but I believe that you are right, because you are talking about the long-term here. What you are talking about is the long game. Like if I set up two accounts, and one account would take a sell and the other account take a buy, but at the exact time, they both had 3:1, for example, overall, both accounts will be profitable even if at that particular trade, one was profitable, of course, and the other one wasn't. Is that what you mean or do you mean something different?

Darren: That's exactly what I mean. The odds and the probabilities would play out over time. Obviously, the only element you can't control in this is the movement of the market. If you have 3:1 1,000 pips, and the sort of yearly range is 900 pips, then it's sort of unlikely to happen in that market. You need to consider the sort of the usual movements of the market within that, but that's essentially what I'm saying.

Walter: It's fascinating.

Darren: I did a post earlier on my thread on the forum. I just ... A friend of mine has been working on a great strategy, and he had an indicator that just draws horizontal lines, and you just decide what space to put the gaps between the lines. I was just trying loads of different variations of size of gap. When you look at it, instantly cries out support and resistance to you, because no matter what size you make the gap, change the time-frame, these lines get respected. You can see why it's so popular, because visually ... It's very enticing visually. You can just trade off these random lines and use random exits and make a profit. I just kind of try and get people to try and stop fixing so much on the particulars of entry and the particulars of price action. I think you can use those elements. I think we give them way too much emphasis.

Walter: I suppose the same could be said of indicators. You place all this importance on the indicators.

Darren: It really is the main problem that people are just basically closing their trades too early. They have a decent method, they are closing their trades too early, so they are not getting the correct risk to reward on their winners. Then obviously the inevitable happens, and they start losing money, and they change their method, and they get caught in the cycle, because their primary focus is on the entry, whereas all along , they are making the mistake themselves. I've even seen people sort of post back test results on my thread on the forum, where they give their results and the say something like, "I always close too early." There is never any emphasis on that. There is never any, "Hang on a minute, actually is the problem here, me closing too early." I think it's because we're just so ... We are kind of like rabbits in the headlights. I think that that's not an important element.

Walter: It's like the guy who's never had a girlfriend, and the first time he gets a girlfriend, he's like, "Will you marry me?" It's the same thing. You get these trades, and you have a lot of really poor trades that don't work out for whatever reason. As soon as you get a nice one, you just want to make it count and cash out. I think this is part of the reason why where ... As humans, we are not setup to trade for profits. We are just set up to lose, basically, and that's just the way we are built. If you are an unusual human, then maybe you are set up to take profits, but that's super rare. I know a trader in Canada, and he was telling me that he's been trading this 4:1 system. He knows he's got a 37% win rate, or whatever, so he just goes for $4 for every dollar of risk. He's actually decided to move it. He's done a lot of tests and he has decided to go down to 10:1. I think it was actually because I mentioned something that you mentioned in a previous podcast or something about the number that was best was 10:1 in the data or something? Someone was testing or something. What was that about?

Darren: That was someone ... It was someone testing a simple trendline break strategy. I think 10 pips risk for 100 pips reward was way ,way more profitable than anything, but at the same time, 40 pips risk for 10 pips reward was also profitable. The extremes were profitable, and then when you got near the center, and you were sort of trading more on a sort of 1:1 risk to reward, then that's where the amount of profit became very low, even losses were occurring. I'm always buying, and I want to buy this trade, the extremes, decide which camp you are going to sit in. Are you are going to go with a wide stop and have a high win rate or are you going to have a tight stop and a high risk to reward. I think making that decision to sit clearly in one camp or the other is really important, unless you can sit in both camps at one time and sometimes use a wide stop and then tighten it up. It's just taking that focus away from the ... Solely on the inventory , really.

Walter: Right, exactly. As traders, we move. We move away from that as you sort of aged and get experience. I think you get further and further away from the perfect entry, and you get more into, "Okay, let's look at risk. Let's look at, am I maximizing maximum favorable excursion and all that sort of stuff." We are just trying to figure out, "Okay, what's going on here with these trades? How can I adjust what I'm doing even though I keep doing the same thing but in a slightly different way in terms of the exits so that I can milk more money out of this, milk more pips out of this?" That's kind of a natural progression.

Darren: Tell me something about your thoughts on the exit, because I Know you ... I might be wrong here, but from what I've seen, when you take your trades, you decide on a first target, and a second target. Really, once these sort of trades kind of go in your way, are you trading to that target or letting it come all the way back to your entry, or are you taking notice of price action in between those targets?

Walter: Normally what will happen is I'll have a first target and a second target, and sometimes I'll have a third target. Typically, a typical trade will be entries triggered, which means it basically has to make a new high or new low. That's just ... I don't know. The numbers of losers that occur because people want to get in on a retracement to me is maddening, but that's a whole other topic. Then what happens is, as it approaches target 1, ideally, it would blow through target 1. What I mean by that is that is if target 1is a support and resistance area ... Say what you want about support and resistance areas, but we as humans, as you've touched on this today, we as humans can see patterns. They're really, really simple and easy to see, and that's why I love trading this... If it blows through that level, if it's a resistance area and it closes clearly above it, or if it is a support area and it closes clearly below it, then I'll move my stop to essentially break-even, and hope and pray that I hit target 2 and target 3. That's the typical thing that I do. That's basically ... It's simple as that.

Darren: Let's say for instance, say your first target is at 3:1, and you get to 1:1 and you get something like a pin bar against you, or something ... Some sort of negative-looking price action. Do you stick with the trade or do you ... Would you ever just close your trade out because of the price action prior to hitting target 1?

Walter: The short answer is, it depends. Occasionally what will happen is I have like a time stop. I learned this from this guy who lived in a mansion in San Diego. I worked for him for a little while. He is a fascinating guy. He had all this mad interest. It was like walking into like a dusty old haunted house. He had stacks of papers and books and all these things. Anyway, he traded, but that was only thing that he did. He always had vast interests. What he taught me was, when you are trading and you take a trade, if you wait tool long, the reason why got in that trade is sort of like the market kind of forgets it. I do believe this about price action. I do believe that price action patterns are really, really good at highlighting what's likely to occur in the near future, but they are not so good at what's going to happen 20 candles from now. My whole thing is, when I take a trade, I want momentum behind me. If I'm in a trade, and it just sits there for 10, 12 candles and literally goes nowhere, a lot of times I'll just pull the plug and say, "Time stop. I've waited ... Momentum was supposed to be behind me, and it's not going anywhere, so pull it." The other thing that I'll do is if really close to may target 1, but doesn't quite get it, I'll also move to break-even. At that stage gets "Okay, this is house money now. Maybe I should have had a target somewhere else, but I'm not going to move my target. Just keep my target where it is." If it comes back and tells me I break-even, it's a trade that never happened in terms of the way I look at it. Those are two most common ways of getting out of a trade. I know you don't do that, right? You just wait. It either stops you out or it hits your target.

Darren: I think some people perhaps as good at reading price action, perhaps, or I think the fear is so much of losing what is already like in their mind winning trade. They perhaps, in the moment, ask, "That's definitely a negatively looking bar. I'd better close." They kind of then get stuck in basically anything at all that is not price racing until they stop, they see as a negative thing and close. They kind of get trapped in that thing of actually never actually getting to target 1. That's something that I definitely had difficulty with. I've tried to kind of evolve rules that although I might manage my position, it more likely may be a reduction in my stop, or at the most, move to break-even rather than close . I think for a lot of people, that can be an issue.

Walter: It is. I agree. You bring up two really good points. One is, if you are taking profits too early, that's a bad habit to get into, because what that does is it shifts the probabilities that you are going to blow up your account. If you have really good numbers in terms of your win rate and your reward to risk ratio, you can get a handle on knowing what your risk or ruin is in terms of ... This is all probably really theory. It's statistics, and you can argue whether or not statistics are useful or viable, or whatever, but according to the numbers and what the statisticians will tell us, they'll say, "You are 0.8% likely to blow up your account." As you start taking profit too early and you shift your reward to risk ratio in the wrong direction, that less than 1% likelihood of blowing up your account, that might become 33%. It could literally shift that quickly that fast if you take profit too early. I think what you are bringing up here is a huge problem that a lot of people aren't aware of, because they think of it in the same way. They think, "I'm taking 93 pips instead of 100 for this, but that is a dangerous habit to get into. As you do that and you whittle away your profitable trades, you reduce your reward to risk ratio, and you just inch closer to destruction. People don't realize that. The other thing that I think you bring up is, people say, "I'm in this trade, and then I get a Kangaroo tail against me, so I better get out." If you trade the way I do ... I'm not saying it's the best way. I'm just saying, the way I look at it is, the market shouldn't ... If I take a trade, then the market is so expanded and volatile and in a swing mode, that in theory, if a Kangaroo tail prints halfway between my entry and my target, that kangaroo tail is printing in no man's land. There is no support and resistance there, and therefore, it should be ignored. It's not important. The only Kangaroo tail that matters is one that prints at a level where the market has repeatedly remembered to reverse there. When people say, "Oh no! Oh no! There's a kangaroo tail against us," I say, "Who cares? There's nothing behind it. It's got no teeth, so just forget about it, and let the trade unfold." If it ends up being a loser, fine, but the point is, getting into this mentality of taking quick profits, although it feels good, is dangerous. I think a lot of traders don't understand the risk of ruin, and they don't understand this concept of, when you start taking profits early, you are literally increasing the odds that you will fail as a trader. People just don't get that. I think that those points you bring up are just spot on.

Darren: It pushes you then where you are sitting in either camp, because you are taking as small stop loss, which generally is going to give you a low win rate, and then you'll not get enough risk to reward. You've sat on the fence, really, with your money management strategy. I think that's a massive problem. It might even be one of the main reasons that people fail. Here's something else. I'm saying that these technical elements really don't matter, as long as you've got the risk to reward et cetera et cetera. Then I look at certain ideas, and they seem to work only on certain parts. That one really flamixes me, because I am a strong advocate of saying, "If it works on low time frame, then it should also work on a high time frame," and so on and so forth. Then I'm kind of saying the patterns don't really matter, and you can trade random patterns. Then I find patterns that seem to just work on one or two parts. What I'm trying to say is, take what I am saying on these element's sort of pinch of salt , because there is always exclusions to the rules. As an example, there's something I tried which is looking for the high and the low of the day. With you, you look for support and resistance to add teeth behind your entries, and I'm kind of looking to see if we are trading off one of the most extremes of the day, if we are turning around from a new high on the day or a new low on the day. This works superbly on the Euro/Dollar and the Pound/Dollar. What I'm doing now, I'm basically forgetting the Asian Range, and then I'm waiting for price to spike up to a new extreme and then turn around. I'm using that new level, that new price level and the reversal as the indication that there's a support and resistance level there. I don't even need to draw the line. I'm looking for the movement of price. I don't want to call it price action, because I think it's more than that. The actual candle shapes don't matter to me. It works superbly on the Euro/Dollar and the Pound/Dollar, but on the Pound/Aussie or the Euro/Aussie and things like, it doesn't work at all, and that's because those patterns on the Euro/Dollar and the Pound/Dollar nearly always happen in London and New York Session.

There are patterns that are significant to certain instruments as well. I think those are much harder to find, but may be more useful.

Walter: That's fascinating. I guess essentially what you're saying is in that case, the reason why the system doesn't seem to work is because the market participants are not in this ... It's not traded at the same volume level. Maybe the Pound/Aussie is traded more often, or there is more significant volume in Asia than there is the Pound/Dollar or something like that.

Darren: Sure. That's clearly what's happening. When I first noticed that, it was just surprising to me, because in the past I would say, "No, if there is a pattern that exists on the Pound/Dollar, then it's most likely going to appear on all level. It could pass as well." It was quite a surprise to me to find that they were. I've recently seen more people do really detailed research on say like the difference between the stock market and the Forex market. There are patterns that are significant, but I think a lot of the time, we as traders focus on the illusionary patterns.

Walter: What's interesting to me is there is all this talk about the algorithms and how they are just ruining it for traders, and yet probably the number one pair that has more robots trading in, more algos are in the Euro/Dollar than any other pair in Forex. What you've just highlighted is a very simple human determined strategy that you use on this pair, and yet everyone else is throwing their hands up going, "The algos are running it for us. This is terrible. The end of days," and so forth, and yet that pair seems to behave in a ...As you can see, for your trading, it seems to behave in a really rationale way, and algos be damned. You are still able to see a very simple way for it to establish a range for you to trade in.

Darren: Definitely. Go and test it for yourself. Look at the Euro/Dollar and trade the turning points so that the current high and low all the day, and it's very ... I do a bit of hedging as well, but I'm not going to go into that on this podcast.

Walter: Sure. I think we don't have time. We are running out of time here, but I wanted to just talk about a strategy that I learned from a guy who was interviewed to be in the Market Wizard ... They wanted him to be in the Market Wizards book, but he refused. He didn't want to have any of that, but it's tangential to what you've talked about today. I'd like to leave that for another podcast, but I think because it's fascinating to me and it's something that's almost like an overlooked thing about the day, and yet I'm sure some people look at it, but I just thought it a really cool way to setup a trade for the day. Anyway, any final thoughts Darren? It's good to have you back. I'm glad we are both feeling refreshed. I'm feeling refreshed because I'm about to take off on a holiday, and you are feeling fresh because you've come back from your holiday. I think this has been a good session overall.

Darren: Holidays are great, Walter. We spoke at length about that in our Sabbatical podcast, but great to see you again, mate.

Walter: All right. Have a good one, and good trading to you.