

2 TRADERS

[EP36: Drawdown](#)

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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 Podcast. It's Walter here. I've got Darren on the line. How are you today, Darren?

Darren: I'm really good. Thanks, Walter.

Walter: Darren, I got this email from a friend, a trader I've known for a while. He's a really good trader and he said "Walter, I've lived in a drawdown now and it looks like you are too. I'm just wondering what do you do here in this situation".

I have some thoughts on this. I think that there's a real danger period for a lot of traders when they get into drawdown and they have few losers in a row. What will typically happen is they'll go one of two ways.

They'll either decide that the market has changed and they'll start adjusting their system; or they'll take a step back and look at over the long haul and just decide to stick with it. If they stick with it, eventually, things will get back to normal which means not every trader is going to be a loser.

But, I think the real danger here when you're in a drawdown is to go ahead and think "Alright, something is wrong here, I need to switch it up. The market has changed. Things are different." Janet Yellen is messing things up or "The Brexit" or the whatever is going on, the war in Iraq, whatever is going on at the time gets blamed for chopping the markets around and moving things around.

The other thing that I like to do, though, is remind myself that there are certain times when -- as a daily chart trader or weekly chart trader -- I might not be doing well. But, the other trader is trading the one-hour chart, or the thirty minute chart, or fifteen minute chart, they could be doing really, really well. Likewise, when I'm doing well in the daily charts, some of those reversal traders on the one hour charts were looking for a reversion to the mean or getting blasted.

It's one of those things where it makes sense to think of when you're trading: who's on the other side? If you're going to take a sell -- you're going to sell the GBP -- who are those traders who would look at the same chart and look to buy?

The same thing when you're on a drawdown. If you're on a drawdown and it has some losers in a row, who are the traders right now who are doing well? Because you should be able to figure that out. Usually, for me, that just means looking out for a different time-frame.

I'm not saying that you should do that and start trading the one hour charts after you've been trading the dailies for years and years. I just think that it gives you a little bit of perspective and it -- really, the way that I look at it -- it's just bad luck.

Whenever I'm in a losing streak, I chalked out on a bad luck. Have I executed my system correctly? "Yeah, okay."

Have I been taken the right amount of risk per trade? "Yeah, okay." Have the markets completely changed and totally made my system obsolete? "Unlikely, unless my system has too many moving parts." In which case, I shouldn't really be using it anyway.

I like to use simple systems that don't have a lot of moving parts. My assumption and my belief is that they will hold up over time, but those are all my thoughts on losing streaks.

What about you, Darren? How do you approach this? You probably have a much different approach.

Darren: Well, I'm in drawdown a lot. Generally, every week, I have some drawdown. There are two kinds of drawdown: there's this drawdown that occurs regularly and is within the realms of the normal operation of your system -- a drawdown that you're quite comfortable with. Then, every now and then, there's just your system couldn't have been any worse and it just completely falls apart.

Those are really rare and I think that probably the hardest ones to deal with. If you have a bit of a drawdown every week or every month trading your system, after a while, you get used to it. You can recognize that it's going on and say "Okay. Now, I know what I need to do here. I'm just going to work through it."

But, there are occasions where I wish I had some way of saying "Look, this drawdown is a little bit out of the ordinary. The market is doing something quite unusual now and maybe I should just really have a break."

Perhaps, even just like my strategy, I can flip time frames. Now, the problem is essentially the same on all time frames. I've never actually been able to do it. One period that stands out in my mind is July and August last year on the GBP/USD.

Where on the daily chart, it had 30 days of just going nowhere which is quite hard to find that sort of scenario over five or six years going backtesting. I haven't found it happening before.

But -- these things do in some of my testings in H1 timeframe as well in March -- I find it really, really nasty period of three or four weeks where it just wasn't working out for my strategy.

In those periods, you would've got a drawdown much more severe than is usual. I'd like to just try and try and have some way of dealing with those. Perhaps, taking a break and have a week off trading, clear your mind, come back and start again.

I'm not saying that's necessarily the best thing to do. Better would be a painful period to trade through. I have two kinds of drawdown: one is a regular expected sort of drawdown that'll get on my system and there's those kind of events where it'll just horribly falls apart.

I haven't really gotten anything in place to deal with them 'cause they haven't been catastrophic, just so very painful to deal with.

Walter: When you say "take time away", is there a certain way that you do that? Like, is it: "okay, I'm down to 15%, I'm going to step away" or is it just kind of a feel thing or sometimes you might step away when you're down 8 or 9%. Sometimes you might step down when you're 15%, 20%?

I guess my question is -- for the listeners out there -- do you have any hard and fast rules or not really?

Darren: Now, I would really go more about how I was feeling. I think if I was in one of those drawdowns that was particularly bad, emotionally, I would start struggling with it and that would be my indication "look, you're not in a good frame of mind to trade here." Hopefully, I've made a good judgment and say "right, you need to have a break".

Now, it'll probably won't work for everyone. When I'm trading, I'm kind of listening to myself as much as I'm listening to the market. That's why I'll be looking out for these intense feelings, intense emotions and my instinct to kick in and say "This isn't a good frame of mine to be trading in. Just have a break. The market would still be here next week".

Walter: Yeah, right. And so, what about those times when ... because I know you want to take a lot of breaks and spend time away from the charts. What about those times? For some traders, these can be the most difficult when you've been away from the charts

and then you come back and you look and you see all of those trades that would've fit perfectly in your systems and you missed them. What do you do for that?

Darren: I'm never a hundred percent away from the chart as well. You still can't resist having a look, can you? No. Probably, with the way I trade, it's a constant flow of opportunities. It's not like -- with your systems -- you'd have a really good support on resistance and a really beautiful price action set-up just how you like it. Price would move to your perfect target. Those would jump out of the chart.

But, generally, when I look at the charts, they all look the same. They're all like random and saggy movement and then the odds spurt in one direction. So, I think, visually we're kind of coming out charts from a different perspective.

Walter: Sure. You take advantage like your trading, as I understand it. Let's say that you have three losers in a row and then you have a winner, that winner could be compounded because you have additional positions that are triggered.

In other words, you're adding to a winner in some instances, right? So, that's one thing that might help you get out of a drawdown that people may not know is that it's not like a one to one ratio, necessarily. Some of your winning trades are compounded because of multiple position poled on. Do I understand that correctly?

Darren: Yes, I basically traded the changing directions. Sometimes, if I've taken a long and reserved sort of a pole that go short, I would change my position if it would turn long again then I've added an extra position. You're adding in the direction of the flow of price, if you like.

Also, I've kind of do my position sizing like the polar opposites to everyone else's as well. Whereas, I use the same lot size regardless of the stop. The way I look at risk/reward is completely different as well. I look at the risk and reward as grips of trades rather than just an individual set-up. That makes a difference as well.

Walter: Right. Potentially, some losing trades would cause more than others and some winning trades would make more than others.

I guess, what I'm trying to do here... Here's what I say and here's what I do when I'm in a losing streak is: "I will not try and make it all back". That's one thing that I'm trying to stay away from.

The over trading bug is something that everyone's been buying and it's terrible and the revenge trading, that sort of thing. I don't do that. Instead, what I'll typically do is spend more time outside. I'm trying to get away from the computer and sometimes I'll take a holiday.

Sometimes, I'll just leave or go away for a while just for a new environment. If I'll do look at the computer, I won't look at the charts. What I'll do instead is I'll look at forex tester. I'll do some testing at forex tester. Just convince myself that what I'm doing works. Remind myself that over the long haul I'm expected to see a profit.

What I'll love to see after I spent a time away from the charts like that is if I come back and look at the charts that I haven't seen for a while, they look so different. I don't know if you've experience it. Sometimes when you're watching the charts -- if you're watching the charts as they print -- you see every little movement up and down and then finally, they come at closes then you see it again.

Sometimes it's hard for you to see exactly what's going on. But, when you take a step back and you haven't seen a chart in a while and then you see all the things that have happened since you last saw the charts, it's like it's a whole new market. It seemed fresh to me. I don't know if a lot of people can relate to that.

For me, in my approach, I think that it's helpful because I can't get stuck in certain ideas like anybody else. You get this confirmation bias where you feel like...For example, as a support and resistance trader, I'll say "the market is likely to hit this level and have some trouble". You start getting this in your head and everything you see is to support that idea.

But, if you spent away from the chart then you'll see whether it did or not respect that level. It's like you're getting a new start, really, which is the same as forex testers. When you're in a forex tester and if you're trading fifteen years ago in forex tester or eight years ago in forex tester, that's a big difference too. That's a different chart as well to the live charts.

Those are some of the things that I like to do to get sort of recharge my batteries. The primary things that I do to make sure that I come back fresh is I will spend time away from the chart. Spend time outside, things like surfing or running or just going out brisk walking or whatever.

If I do sit down in front of the charts, I will look at forex tester charts, test my systems, get some confidence that what I'm doing is going to work over the long haul. I will also try to stay away from the live charts if possible, even if it's only from a few charts. Maybe, I'll just don't look at the Aussie or the Swissie.

Then when I see those charts, it's a completely different story. It feels fresh and I don't have that confirmation bias working against my trading. Before, I was so convinced that the support and resistance level on the Aussie was going to hold. Now, I can see

what it is which is -- well it held there for a little while and then it blew right through it.

These things make sense to me where you come out of it with fresh eyes, where you get reinvigorated. You build up your confidence again. That's one of the things that suffers when you're in a drawdown; your confidence isn't working anymore because it's broken.

What's going on? What do I need to fix? What I'd do wrong here? All those things start to creep in when you're in a drawdown. Those are just the tools that I used. I guess, from my point of view and the listeners here, I'm wondering, do you have any sort of brain hacks or tricks that you can use when you're in a drawdown to help other traders out?

Darren: It very rarely happens to me that I'm having a really bad drawdown worse than I expected in my normal trading, anyway. Likewise, I just step away from the chart.

I think maybe a few years ago, I wouldn't. I keep trading and probably sort of make more mistakes and like you say "trying to win the money back too quickly." You're learning in time that it's not going to help you in the long run.

But, do you have like a set sort of figure in your mind of when things are going wrong or do you --like me -- do you just like, "I'm not feeling good about this and how I'm feeling about it"?

Do you have a predetermined like, if I go over 11% drawdown then you know, then I'll take a break or do you just use your feeling?

Walter: I just use my feelings, really. I used to use a hard 10% level as I would stop trading for two weeks and just like a built in break is made.

The main question I have is, looking at the charts, "did I execute my systems correctly?" If the answer is yes, it doesn't really matter, drawdown just chalked up the bad luck.

We know the longer you trade, the more likely you are to experience an exceptional string of winners and losers. You keep drawing numbers out of a lotto and eventually you're going to see weird combination come up. Things like that.

That's just the way it works. My main concern when I'm on my drawdown is: "is it me? Am I executing incorrectly? Am I doing something weird?"

If that's the case, then I'm concerned. If I'll look at the trade and say -- like the one I took last week, which is a loser -- if I look at the trade then I say "I will take the trade every single time". There's no way that I will be looking at that trade for any reason and say "That's not a good trade" so, the fact that it didn't work out, I don't have many things to offer there other than to say "it's a bad luck."

As traders, we look for reasons. As humans, we look for reasons and we forget that in trading, there is luck involved. There are lucky trades and unlucky trades. That's something that you can legitimately say "well, that was an unlucky trade". That's why I was a loser, wasn't because I messed up my system.

It wasn't because I took on too much risk. It wasn't because I forgot this has to be a part of the trade as well. I just disregard that and it's not because of any of that. It's just because it's bad luck.

To me, it's not that big of a deal and you also don't feel as bad. It's not part of your problem if you have an unlucky trade. The blame is outside of you now so that also feels better, but it's a truth from keeping people to go through. If you're not aware of what likely is to be your drawdown on the future.

When I say that, I mean drawdown and how many consecutive losers are you're likely to have given the parameters of your system. If you're not prepared for that, it can really hurt when it happens.

It's something that definitely dig into and take a look out because a lot of traders are unaware that when they have 51% win rate, the chances of them having eight or nine losing trades in a row is great. It's very, very, very high. These are the sort of things you have to look out.

Darren: Yeah, but my win rate sits around 50% pretty much permanently nowadays. Since the start of the year, I've had a run of seven winners and I've had a run of eight losers which was just the other week actually. Surprisingly enough, it didn't feel so bad --those eight losers -- because when I was looking out at the market, I was taking the right entry. I was managing them fairly well but the market just happened to go against me.

Drawdown is something that people really have a difficulty with. I think they try too much to remove it from their trading. They'll backtest lots of data and see that there is a drawdown but it makes profit every time. That's why they go on trading it.

When they're actually in the moment -- especially if they've had a particularly nice win streak -- if they give half of that back, they found that very difficult to deal with. It's a good point you made where you look back and it was a good set up and you would

take it every time but it'll get lost and you just accept it and move on and that's one of the key lessons to learn, really, is just to start accepting that you'll have drawdowns. Sometimes, it'll be above and beyond what you expect best part of the game.

Walter: Yeah, exactly right. That's why we get paid as traders for taking on risks and the likelihood that the money might be gone when the trade is over. That's something that we have to keep in mind.

If you're one of those people who really likes to win... For example, you're a great business person and you've crashed your competition. You have like a bicycle store. You've crashed all the bicycles stores near in your vicinity and you've just won.

I don't know if trading is really going to be something that you're transitioning into easily because you have to deal with these drawdowns. You have to deal with these losing streaks. It's part of what happens and if you get a little bit funny. Like, as the bicycle business owner, when you see a competitor take out an add on the paper, you might take the full page out or whatever.

We're all out on their coupons. You can get really nasty because you want to win. That approach, I believe in trading, doesn't work. It can be a big problem. It's a difficult thing to deal with. I think that once you start to take the approach, it's not you. It's just a part of trading then it doesn't hurt as much.

It's a difficult time for traders. One thing that you'll have an advantage in that is you know that you've got a 50% chance of winning. These are to be expected like you say every week, there's some sort of drawdown.

Now, hopefully, by the end of the week you've pulled out of that and made money. It's just part of the deal, that's how you see these things. You know that's eventually will going to happen.

Darren: Even if you're trading blindly, probably you'd get 50% win rate. You've given a bit of scope for. It's rare for it to drop much below that but you do get spikes where it performs better as well.

I used to try and have the high expectancy trading systems and I just found out that made it harder to deal with because it's much harder to maintain those high win rates, really.

Walter: Well, I appreciate your time, Darren. Hopefully, we've given the listeners here some ideas on how to deal with drawdowns and that's not something that ruins your trading or your system because I think that's the big danger. You've changed to the main things because of your drawdown. Thanks for your time, Darren.

Darren: Okay, Walter. See you soon.

Walter: See you soon.