

# Four Principles of Successful Trading

**Why do successful traders keep making money year after year, while newbies lose everything within the first few months? What is it that most beginners get wrong? How do successful traders know what's right?**

My colleagues and I are often asked how to succeed in trading. In fact, we have been asked this question so many times, that I have finally decided to write a trading report; a report that will give you straightforward and easy-to-follow advice on how to become a better trader.

Unlike most trading advice articles, this report is written in a clear, plain-English manner. I am going to describe the very essence of the problem in a concise and coherent way. You will read about major mistakes that prevent traders from making money and learn the basic principles that took successful traders years and thousands of dollars to discover. All the facts in this report are based on years of observation and can be easily verified.

## **You'll Discover:**

- How You Can Recognize the Trading Methods That Work
- What Successful Traders Use
- How to Make Your Profits More Consistent
- How the Money-Making Process Can Be Automated

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**From Andrew Kirillov,**  
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Dear Colleague,

**Have you ever felt like you have finally learned how to predict market moves after a winning trade? And then felt desperate only a few days later – after a devastating loss?**

Now imagine the feelings of a trader who spends years studying price movements, buying expensive indicators, following expert advice, and attending seminars. However, this trader keeps losing money until all their savings are gone. He then raises more funds, loses everything again - all the time wondering why, contrary to all the guru promises, he can't turn trading into a profitable business. Nevertheless trading is just as *understandable, predictable and profitable* as any other business.

Just imagine that after years invested in trading you still won't be able to understand how markets work. How frustrating would that be?

Or even worse: what if, driven by emotions, you lose control and, as a result, all your savings? Do you have an emergency plan to protect yourself?

How quickly do you think you could recover from heavy losses, if at all?

Not only beginners but also 'experienced' traders tend to ignore or forget about taking steps to protect their capital against these types of catastrophes – until disaster strikes. By then it's too late and the damage is done.

### **But That Could Never Happen to Me!**

*(And Other Lies Traders Like to Believe about Their Trading Practices...)*

After working with over 1100 individual traders and institutional customers in Europe and the USA, we found that 9 out of 10 traders will experience some type of losses that will end up costing them between several thousand to several million dollars.

This doesn't include money spent on manuals, trainings, seminars or months of painstakingly analyzing the market.

Losses incurred in poor trading practices differ in each particular case. However, whatever those losses may be they are always too high for the trader involved. As a rule, people lose all their disposable money. Even worse: sometimes they go even further and get dragged into debt.

**Take a look at these statistics:**

- **90% - 95% OF ALL TRADERS LOSE MONEY** *(Source: Ryan Jones, the author of *The Trading Game, Playing by the Numbers to Make Millions*)*

- 70 percent of day traders lose money (*Source: 1999 study conducted by the North American Securities Administrators Association (NASAA)*)
- 95 percent will fail in the first two years (*Source: Harvey Houtkin, February issue of Securities Regulation and Law Report*)

## **What Do These Statistics Mean for You?**

The facts above clearly demonstrate that most people underestimate the risks of trading. In most cases, they are simply misled by advertising from brokers and consultants. As a rule, brokers don't care about your long-term success because their goal is to quickly earn back the money invested in attracting a new customer. That's why they want you to start trading as soon as possible. To achieve this goal, brokers provide beginning traders with minimum information that is just sufficient to make trades (and thus to generate commission that brokers live on) and let them fly blind in the market. Such unscrupulous practices have even drawn attention of various governmental agencies supervising and monitoring securities trading. Unfortunately little success has been achieved in curbing these practices.

The sad truth is that most trading consultants sell trading methods that don't work. Of course, these methods are presented not only as working but also as highly profitable. As a rule, a potential customer is shown the few occasions when an indicator (or some other analysis method) happened to predict a good trading opportunity. What happens to be left out of the picture are all the occasions when the method led to disastrous trades.

Furthermore, trading gurus avoid selling their strategies as a set of formally defined objective criteria to enter the market. The main argument is that indicators must be applied differently in different situations. Gurus claim that no algorithm-based system can substitute human intellect. Of course, this kind of reasoning is extremely convenient. Whenever the advertised trading method brings disastrous results they blame the trader not the system. Since everything depends on the trader's subjective determinations, it's impossible to prove that it's the method that doesn't work. You are the only person to be blamed for those losses.

**What's most exasperating about this situation is that most of these disasters and unnecessary costs could have been completely avoided or greatly mitigated easily and inexpensively with a little analysis and proactive verification.**

## **Why Are Beginning Traders Particularly Vulnerable**

Today's markets are becoming increasingly efficient. To survive in this highly competitive environment, unconventional tools and methods are called for. However, contrary to common sense, beginning traders don't even try to use the latest market analysis tools. Instead, they use methods that worked quite well 30 years ago but are totally useless nowadays.

Institutional players, on the other hand, are equipped with state-of-the-art methods and technologies. Trading futures is a zero sum game. In this game, newbies invariably fall prey to the more advanced players.

## **\$45,000 Spent Just to Discover That a System Doesn't Work**

One of my customers purchased a set of indicators from a well-known and respected trading expert. The method consisted in waiting till all the indicators showed a favorable point to enter the market. Of course, such trading opportunities don't come up every day.

You'd think that common sense should have told this customer to paper-trade his method first – to see how well it would work in the real market. Unfortunately, emotions and the expert's convincing arguments proved stronger. He took several trades that emptied his \$45,000 trading account.

I tried to persuade the trader to have those indicators coded into a comprehensive and objective system and test it against historical data. My reasoning was simple: what didn't work in the past probably won't work in the future.

Out of pure curiosity I coded those indicators into a system and tested the system on different trading instruments and resolutions. The tests proved that the system didn't work.

If the above trader had spent \$900 on a back-testing program and \$200 on coding his system, he could have saved \$45,000!

## **How Slow Reaction Once Cost Me \$2,000 in 5 Seconds**

At some point, I was combining software development with trading FOREX. This active trading gave me a good feel of the tasks and problems that traders face and allowed me to develop software to improve my own results.

I was once trading a system based on the Federal Reserve System interest rate announcement. My strategy correctly indicated the entry direction. Unfortunately, back then I wasn't using automated trading and had to manually adjust the stop loss as soon as the market started moving in the favorable direction. The broker I was using didn't support trailing stops, so manual adjustment was the only way to trade with my method.

As soon as the profit reached the required value I started adjusting the stop loss. Unfortunately it took me too long and a potentially lucrative trade was closed with a loss. The market gets highly volatile following news releases, therefore 5 seconds for manual correction was way too long. If I had managed to adjust the stop within 2 seconds, I would have made \$2000. Automated order execution allows reducing the reaction time. It will take your computer 1 second or less to react and modify an order.

Thus, a one-time investment in automating my strategy worth just 1/10 (or \$200) of just one losing trade could have completely changed the outcome. And who knows how many similarly unsuccessful trades will occur in future?

## **Six Consecutive Losing Trades Made a Trader Give Up on a Working Trading Method and Miss a Rare \$35,000 Trade**

The manager of a 50 million dollar investment fund told me about a loss that wouldn't have happened if they had adopted the well-known practice to diversify traded instruments. Richard, one of the fund's analysts, was trading on exotic markets using an automated trading system. The system had been tested before and had proven reliable and profitable. Tested against historical data, it had never shown more than 4 successive losers, which was normal for this particular system.

However, in real-world trading the system generated 6 consecutive losing trades and Richard decided to drop it. He found it psychologically difficult to use the method that seemed to have stopped working – even though he knew that the market was being sluggish and the system's behavior was totally natural under the circumstances. As soon as he stopped using the system, the market entered a growth stage and this trend-following system started working again. As a result an excellent opportunity to earn \$35,000 on a single contract was lost! This costly mistake could have been easily avoided, if they had been trading a portfolio based on uncorrelated markets. It would have ensured a steady profit growth irrespective of the conditions on a single market. Other profits would have nullified 6 losing trades on this particular instrument.

When I asked Richard why he didn't use diversification, he said that the reason was quite simple: the company wasn't paying enough attention to the issue and he didn't have the software to make an efficient portfolio.

The unwillingness to factor in quite a predictable situation as well as the desire to save \$2,000 on software resulted in losses 20 times exceeding expenses on the necessary research.

### **Four Things You Must Do at a Minimum to Protect Yourself from Common Mistakes:**

While it's impossible to plan for every problem or emergency, a little proactive analysis and a few simple rules will help you avoid or greatly reduce losses.

Unfortunately, I have found that most beginning and even many experienced traders are NOT conducting any type of analysis, which leaves them completely vulnerable to the types of disasters you just read about. This is primarily for four reasons:

- #1. They don't understand the importance of verifying trading systems
- #2 They use outdated market analysis techniques instead of adopting the latest and most efficient approaches
- #3. Even if they do have a good trading method, they can't use it efficiently
- #4. They rely on profits from a single strategy/instrument and don't try to diversify their portfolio

While there are over 20 critical tasks that need to be performed to succeed in trading, I'm going to share with you the 6 that are most important for protecting your capital and creating the most favorable conditions for a profitable and consistent strategy.

## **Step#1: Don't Trust Any Trading Ideas**

I never stop wondering what makes people blindly trust the so-called gurus. I have lots of facts proving that most gurus are nothing more than frauds. However, my main point is that you shouldn't trust anybody, not even yourself. You are the only person responsible for your trading failures and successes. If you fail, the only person you should blame is yourself. If you have a trading idea you must test it. All assumptions and untested ideas cost too much. You simply can't afford it!

Therefore, before you start trading with real money, test your idea under conditions as close to real life as possible. The more accurate the simulation is, the more reliable your tests will be. Be critical and objective when making conclusions. Trust statistics, not your feelings or beliefs.

## **Step #2: Learn From Those Who Really Know How to Make Money While Trading**

Study the practices of those traders who take money out of the markets year after year. Unfortunately, finding such people is a major challenge. Most gurus you'll meet will tell you that they are extremely successful and that they teach trading just for the fun of it or out of pure generosity. I'm afraid that in 99% of these cases all their success stories will be lies.

I only trust statistics coming from unbiased sources. For my analysis I rely on ten-year reports on the best Commodity Trading Advisors (CTAs). Obviously, anybody could be making money for 1-3 years due to sheer luck. Data spanning 1-3 years isn't statistically reliable and can't be trusted. This is why in the ten-year reports, I single out those traders who have been making steady profits for more than 3 years.

Most successful CTAs rely exclusively on mechanical methods and automate their trading to be faster than everybody else. Also, they always diversify their trading.

If you analyze the trends in the algorithm-based trading industry, you will see that most of the solutions out there have been created for institutional traders and cost thousands of dollars. The high demand for algorithm-based trading on the part of institutional traders is only natural. They understand that the best trading opportunities can't last long. Mere seconds separate winners from losers.

Today's markets respond well to arbitrage strategies and high frequency trading. These methods, however, call for reliable mechanical trading systems and high-quality software to deploy them.

I must point out once again that the primitive systems that most newbies get a hold of ceased to work long ago. In the 1970s, even basic trend-following strategies worked fine because the markets weren't as volatile and fast-paced as they are today. Nowadays, markets require brand-new methods that you won't find in old trading manuals.

### **Step #3: Run Multiple Tests of Your System under Various Conditions**

I am not going to deny the benefits of paper-trading, but I prefer backtesting. Backtesting is the fastest, the most reliable, and most objective way to test a trading method in different situations without letting emotions interfere with your judgment. When testing your trading idea in real-time on a simulated account, it's impossible to ensure that your tests are error-free and extensive enough to be statistically reliable. I've met few people who would be prepared to paper-trade a strategy for at least 3 months before switching to real-world trading. As a result, their conclusions about the strategy's workability and performance are highly subjective and rash.

Backtesting allows trying a method against different historical data and across different financial instruments. It also ensures that the results are unbiased and consistent. Of course, there are a number of backtesting rules but those must be discussed separately.

Invest just a couple of hundred of dollars to have your strategy coded or spend a few hours of your time to do it yourself and you'll find out if the tested idea is worth anything. I can assure you that you'll reject 99% of the systems that you thought were a sure thing!

### **Step #4: Don't Miss the Benefits of Optimization for Fear of Curve Fitting**

Most people regard optimization with apprehension because in most cases it is applied incorrectly and therefore leads to devastating results. Most people optimize their trading systems to find the best parameters. However, optimization must be approached in a completely different fashion. How do you create a new trading method? You visually scan data for patterns and check how well those patterns work in various situations. Such eyeball tests are nothing less than implicit optimization.

For example, you will use a moving average with the length of 20 and won't use a moving average with the length of 25. Why? Because you can see that the 25 moving average can't predict market moves as precisely. In other words, you have visually optimized your strategy. The danger of such optimization though is that the chosen value of 20 can be completely random and have no rational foundation.

Optimization is vital for solving two tasks. First of all, eyeballing data for the best parameters is too tedious and time-consuming. Moreover, you might simply never manage to find those best parameters. Let the computer do the job and do it much faster than you would. For example, with the help of the genetic optimization I can test hundreds of indicators with different parameters and find out what works and what doesn't. Visual analysis of the same set of indicators would take centuries.

Second, optimization ensures that the discovered optimal parameters aren't random or over-sensitive to changes. Just create a 3D optimization graph with one click and you'll see how robust your strategy is. If even minor changes affect the strategy's performance and there are no logical explanations for each value, you're simply using an over-optimized system that might look nice when tested, but will result in disastrous losses in real-world trading.

## **Step #5: Trade Several Instruments to Ensure Consistent Profits**

According to experts, it is vital to trade several uncorrelated instruments. Diversification allows compensating for unfavorable trading periods for a particular instrument while steadily increasing the overall size of your trading account. Obviously, even the most consistent strategy will run into periods of losses. This is the normal dynamics of trading. At the same time, traders find this phenomenon extremely difficult to deal with. They feel like the system is no longer working because the market has changed. These assumptions can be contrary to reality but more often than not they override logic and common sense and lead to poor decisions.

To eliminate or at least minimize this effect, several strategies must be traded in uncorrelated markets. This way you will ensure a steadier capital growth and abate losses during unfavorable periods. Profits from trading one of the instruments will compensate for the money lost on another. The result will be a modest but steady growth which is the most important thing in trading. Today, creating an efficient portfolio isn't such a difficult task. Portfolio-level backtesting is now available for a reasonable price. Just a few years ago only large companies with enormous budgets could afford portfolio backtesting.

## **Step #6: Automate Your Trading Method to Avoid Errors and Routine**

It is a well-known fact that a good signal is not enough to enter the market. The latest trading methods call for the best possible entry price. This is especially true for high frequency trading. Human reaction isn't quick enough to respond to price changes within milliseconds. At the same time, the price can change several points which will result in a smaller profit or even in a loss.

Latest software products make automated trading perfectly feasible. All you need to do is code your strategy and enable auto-trading. Of course, the trader still must monitor the automated strategy execution and interfere should the situation call for such actions – just as the pilot of an auto-piloted plane may be forced to do.

There is another important reason to automate your trading. There's no point in staring at your computer screen 8 hours a day not to miss a good trading opportunity. And what if you're monitoring a portfolio consisting of dozens or hundreds of instruments?

Instead of wasting your time like that, you could use it to do research and improve your trading methods. Let the computer do all the routine work. This approach will make trading exciting and far less tedious which is particularly important if you want to dedicate most of your time to trading.

## **Announcing a Simple and Easy Way to Ensure that the Recommendations above Are Put to Use:**

If you are sitting there thinking, "This all sounds great, but I don't know where to begin," I've got the solution.

**Download a fully functional version of MultiCharts and use it for 30 days for free!**

**<http://www.tssupport.com/products/multicharts/trial/>**

Good Trading,

Andrew Kirillov, Founder

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