Rules for Forex Trading

A practical guide to keeping your shirt and compounding your account

Who am I?

I am an anonymous non-professional trader who does not fit the stereotypical profile for a trader. I do not have a business degree, I have never worked for a major bank (or even a corporation), and I am not even all that enamored with money. My interests are primarily concerned with arts and letters, and I am a doctoral candidate in philosophy. So why do I trade? I see trading as a means to free ourselves from working and pursue the things that make life worth living. That is all.

Though I greatly enjoy trading, I will be doing this only as long as it takes me to secure my financial future. This document is not a prelude to a signal-selling service, and I have chosen anonymity because I do not wish to be known for my trading. There are better things to which one can attach their name. My aim is simply to help other traders on their way to wisdom and wealth. Enjoy, and don't lose your money.

Introduction

For any purposive activity we may undertake, we can articulate clear rules for fulfilling the goals we set out for ourselves. Should we neglect these rules, sooner or later we will fail to achieve what we set out to do. The truth of these statements ought to be self-evident. Yet time and again, we find ourselves confounded by our emotional whims, discarding our well-considered blueprints to recklessly pursue that which we desire.

In no other activity is this tendency more evident than the financial markets, fueled as they are by human greed. Yet, markets only thrive on greed. Without it, they would cease to exist. The irony, of course, is that there must be logical rules in place such that one can profit from the greed-fueled movements of the market. In trading, greed and reason are made to cohabit, strange bedfellows in the pursuit of material wealth. This irony becomes perverse when we consider that this pursuit is motivated by the desire to free oneself from the material scarcity that gives rise to greed in the first place. More often than not, however, we trade simply because we desire to retrieve our precious freedom from the devil that we call “work.”

We can beat the devil. But we cannot do it in a haphazard way. We must have a logical trading plan in place, and the resolve to subordinate our greed to reason. This can only be accomplished by obeying clearly defined trading rules. This document provides not a trading system, but a set of general rules for the trader who is serious about profiting from the fluctuations of the market, no matter what his or her trading style may be.

I am a trader of currencies and my focus here is the forex market. However, many the principles contained herein can be applied to any commodity or equity market. Whether one is trading pounds or pork bellies, for pips or points, trading is trading.

These rules are to be followed to the letter. Ignore them at your peril.

Rules summary

- Define your long-term goals
- Treat trading as a business
- End every day in profit
- Every trade must conform to objective criteria
- Never force a trade
- There's nothing wrong with getting out early if you are in profit
- Always have a profit target for the day
- Always stick to a small daily profit target
- Your initial trading stake should be small
- Do not enter a trade without a profit target
- Always set a hard stop
- Do not trade unless you are nearly 100% certain about what will happen
- Do not trade when signals are mixed
- Follow your system
- Don't lose your head
- Identify key support and resistance levels
- Look at longer timeframes for both support and resistance, and for clues regarding future price direction
- Be aware of peak market times
- Be careful when trading in the Asian session
- Don't trade thin or directionless markets
- Be careful when trading forex on non-news days
- If you trade intraday, don't enter a trade unless you can actively focus on it
- Avoid reversing trades
- Stay out of the market near news release time
- Watch your broker like a hawk
- Don't go crazy with leverage
- Stop trading after two consecutive losses
- Take profits quicker after a losing streak
- Don't gloat over your winners

- Be wary of chat rooms and online forums
- Don't buy systems
- Stay healthy
- Don't give up

RULE: Define your long-term goals

It is important for you to articulate *why* you are trading, and *what* you hope to achieve by trading. If you answered "I want to get rich, and I also want to get rich," you are missing the point. Of course, one should articulate monetary goals. Specifically, one should calculate the amount of money that would be needed to do two things: (1) quit one's job and live off the income from his or her trading; (2) compound the trading account even while making regular withdrawals. But the point here is to think beyond the bottom line. We need to think about trading as a means to furthering specific life goals that you have defined in advance. It is important that you do this in order that you do not come to view trading as an end in itself. After all, money is merely an instrument that allows us to procure what we need and desire.

The phrase "trading for a living" implies that trading is one's profession, to be worked at in the manner of a regular job or career. While it's true that we must adopt a professional attitude toward trading, it remains that we are trading *for* a living, not *as* a living. Some people are drawn to trading because they want to "get rich quick." The rest of us are drawn to it because it is an endeavor that allows us the opportunity to acquire the financial means to live our lives as we please, *if done properly*.

One ought to be trading to have a life, and not living to trade. If you do not articulate the life goals that motivate your decision to trade the markets, you may find it difficult to stay focused while trading. We must be calm and cool, and thinking about money bags and gold bars and mansions is only going to distract us. Clouded by visions of riches, one becomes reckless.

There is also the tendency to become fascinated by the markets because one develops a true passion for trading. Of course, one should enjoy his or her chosen career, whatever it may be. Trading, however, is a career that must be pursued dispassionately. Even if you enjoy trading immensely, you should not trade for the fun of it. Trade only when there are real opportunities from which you can profit. This brings us to the next rule.

RULE: Treat trading as a business

In talking to other traders, I have encountered a kind of desperation: "I must make 20 pips a day!" A desperate mindset such as this will only lead one to become even more desperate as his or her trading stake dwindles to a fraction of its initial value. Successful business ventures are not born out of *aspiration*, not desperation, and trading is most definitely a *business*. We must therefore adopt a business mindset in order to succeed. This means that we must aspire to very specific goals in accordance with the rules that follow. If we do this, the pips after which some traders desperately chase will actually follow quite naturally.

RULE: End every day in profit

This is your golden rule. It does not matter if your profit for the day is 1 or 50 pips. If trading is a business, and the goal of every business is to end every day in the black, then that is your task when you sit down to trade. Every day that you do this, no matter how small the profit, you are growing your capital.

This seemingly obvious point is easily lost when we find ourselves in a bad trade, or even worse, a string of bad trades. It has happened to all of us. One rationalizes in order to stay in a trade that is no longer justified by what the currency pair is actually doing. Perhaps "it will come back," but that is hoping, not trading. You don't know if the currency pair will return to your entry point. And by the time it does, a margin call may have already emptied your account of precious capital. Can you imagine having gone long on the GBP/USD at $1.95 in 2004? Highly leveraged traders who hoped that the pair would go back up lost all of their money a long time ago. (At the time of this writing, the pair is now trading over $2.00 after a decline to the 1.70s.)

Stay focused on the goal. Exit your trade *immediately* if your position is not acting according to your expectations when you entered the trade. Stay in winning trades so long as you remain in profit, but do not give too much profit back. If you are day trading, once you are profitable by 10 pips, you should exit a winner, with at least 2 pips. Once you are profitable by 5 pips, you should exit at least break even. As soon as your position nears zero, get out. Do not exit your position unless you are at immediate risk of losing your profits, which you should *always* keep.

For intraday traders, 10 pips is a good stop. Perhaps 15 pips is justifiable if you are trading a volatile pair. But no position should require more than that unless you are planning to hold your position for more than a day. Human beings are fallible, and bad trades are inevitable. You can always get back in later, but a 10-pip loss signifies that this particular entry was ill-timed. If you keep your losses to 10 pips *or even less*, you are allowing yourself plenty more opportunities to trade, even if you get yourself into a situation where you overtrade and take a string of losses. You must allow yourself a margin of error, even catastrophic error. 10 pips per bad trade will give you this margin. I don't even like it when trades go that far in the red. Often I will get out as soon as -6 pips if I don't like the chart action.

If you are trading longer term, your stop loss must be tailored to the market in accordance with established levels of support and resistance, and also the average daily range of the pair. Since your stop will be wider, you must take care to use fewer lots, and size your position such that you lose no more than 5% of your equity on one trade, and ideally less.

One final point here: deciding *not* to trade because market conditions are unfavorable is an excellent business decision. While you won't make money, you won't *lose* it either. If you don't lose, you are still furthering the goal of being consistently profitable.

RULE: Every trade must conform to objective criteria

If you cannot state to another trader *exactly* why you entered a trade, you should not have taken the position. This is true even if you end up winning. You must have a clear notion of how you expect the pair behave, which ought to have its basis in level-headed analysis and *nothing else.*

Here are some irrational reasons for why traders get into trades, along with my rebuttals:

- It "looked" like it was going up/down.
    - According to what criteria? Take off the pip goggles and *think*.
- I won on the last three trades, why not take a fourth?
    - *Why* take a fourth? You are pushing your luck. Three winning trades on any given day are more than you have the right to expect or wish for.
- I lost on the last three times. This trade *must* be a winner!
    - This is a gambling mentality. The market is not a subjective entity. It offers no guarantees, and it does not care whether you win or lose. It will do what it does anyway.
- I have to trade *something.*
    - No you don't. You probably have to clean your house, feed your pet (or yourself), or sleep more than you need to take a trade. Never force a trade.
- I *know* I am right about this market, and it's just a matter of time before the market does what it "should."
    - How do you know? No one knows. All predictions are fictions! Opinions about the market's future direction, regardless of how many fancy indicators or pivots or Fibonacci levels you have at your disposal, are bogus until proven by the market. The sooner you own up to your lack of control over the market, the more successful you will be.

RULE: Never force a trade

This is the corollary of the previous rule. Traders, especially beginning traders, are prone to the excitement of trading an active market. As stated earlier, emotion, particularly the emotion of greed, is more powerful than reason. One must do everything within their power to block out all emotions when trading.

One ought not to be looking for reasons to get *in* the market. If anything, the opposite is true. Good trades are consistent with carefully developed trading rules. They present themselves to the experienced trader as obvious opportunities, long having since trained his or her eyes to recognize them when they appear on the screen. When these opportunities are not present, the experienced trader will look for reasons *not* to enter trades.

When you start looking for reasons to get in the market, you risk forcing a trade. A forced trade is one that is taken when a trader has either fudged his or her trading rules, or traded without regard for rules at all. Such trades are taken from the emotional standpoints of excitement, revenge, desperation, or even boredom and/or apathy.

Don't ever force a trade. If you feel yourself desiring to trade when there is no objective basis for doing so, get up and walk away from the computer. Better yet, shut it down and do something else, for you are clearly not in the right state of mind to trade in the first place.

RULE: There's nothing wrong with getting out early if you are in profit

Contrary to what some other traders think, I do not think early exits are bad. If you exit with profit, you are acting in accordance with rule #1. If you are unsure of what is going to happen because the market has given you no clear indication in this regard, you *should* get out. So what if you only made 2 pips, or even 1 pip? You made money. When the market clears up and presents a trade that conforms to your entry rules, then by all means jump back in.

The problem with the early exit strategy is not the technique, but the type of trader prone to it, i.e., most of us. Traders who frequently get out early are often the same traders who will hold a losing position for 20 or more pips. You must get out of your losers as early as you would your wobbly winners. Otherwise, exiting early loses its effectiveness as a trading tactic.

"Letting your winners run" only works when your position is running in your favor. When the running stops, the race is effectively over. You've won! Now take your profit already. For unlike an actual marathon, the runners of the market can start traveling in the other direction, turning a medalist into an also-ran.

RULE: Always have a profit target for the day

This is important because it gives you a goal to focus on, and eventually allows you to *stop* trading for the day.

It is not healthy to sit in front of 8 monitors for 14 hours a day in an effort to catch every single move. After a string of winners, overconfidence or fatigue will set in, and eventually you will have a losing trade. Then in addition to being tired, you will be mad for having lost at all, and soon you will experience another losing trade. And then another. Before you know it, you will have lost your profits for the day and then some.

The goal of this business of trading is to compound one's winnings so that you can live your life and do what you want. Compounding is best achieved by keeping to a modest daily profit goal. Once this goal is reached, trading ceases until the following day, when these steps are repeated. As the account grows, one is gradually able to put on more lots. Although it is exhilarating to happen upon a trade of 50+ pips, compounding small winners is the key to riches for the intraday trader. Your profit target should be modest. Beginners should shoot for between 3 and 5 pips. Intermediate traders can shoot for 10. Advanced traders can try for more *with great care*. As your account grows, you can gradually put on more lots.

Once you've made your pips for the day, turn off your computer. Get some breakfast. Take a walk or a nap. You've earned it. And if you MUST trade, close down your real account and open up your demo. However, you want to get to the point where this desire to trade does not exist at all. So long as it does, you are living to trade, and not trading to live.

RULE: Always stick to a small daily profit target

Again, small daily wins are the key to success. This may be the second most important rule after rule #1. The chain of events that justify this rule generally follows this chronological pattern:

1. After a string of losses, you calm down, screw you head back on, and finally start to see the market clearly. You make one or two trades and meet your daily target.
2. Relieved that you have been able to do this, you start to see good trades regularly. You take some of these trades for wins, and you realize that your target is well within your reach, several times a day.
3. At this point, trading starts to seem easy and you are making money left and right. Overconfidence and greed sets in. Long before this happens, you may have already been overtrading.
4. You begin to lose and eventually give back all of your profits.

At this point, one of two things happens:

- You stop trading and assess what happened (which is, in fact, what led this author to write this rulebook). Having calmed yourself down, eaten a nice meal, etc., you return to step one above. You finish the week in profit, only to realize that *you would have* *made the same amount of money all along if you had only stuck to your small daily target!* Think about the time that you could have spent doing other things!

- You get desperate and lose even more money, so much that you are FORCED to stop and assess what happened. If you are a beginning trader, that this will happen at least once. In fact, it will probably happen multiple times. Ah, you say "oh, not me!" Yes, *you too*.

If you end up making the same money overtrading as you do when trading minimally for a small profit target, why overtrade? If we always acted with our heads, this question would never arise.

The compounding that can be realized by fulfilling and sticking to a small daily target is mind-boggling. For example, let's say you have $2,000 in your account. You resolve not to lose either 5% of your equity or 20 pips on every single trade that you make. In other words, a 20 pip loss would mean a decrease in equity of 5%. And this would be a worst-case scenario; ideally you would exit much earlier.

To size your position, you would first divide your account size by the risk percentage (.05) to get the capital amount to be risked. Then you take that number and divide it by the maximum pip loss. The result, which you always round down to a whole number, is the dollar amount per pip that you are allowed to trade, regardless of the leverage offered by your broker. To illustrate:

$2,000 * .05 = $100 / 20 = $5 per pip.

$5 per pip means that you can trade 5 mini-lots. Only a mini account will give you the flexibility to trade the exact number of lots appropriate to your account size, and some brokers are less flexible than others.

Now, for the compounding realized by fulfilling a 5 pip daily target:

- After two months of trading (40 days), your original $2,000 has become $3,170. At this point, you are now trading $7 lots.
- After six months, you account is now worth $9,300, more than 4 times its original size. You are trading $24 lots.
- After a year, you have $46,945 to trade with. Your account has increased twentyfold, and you are trading $114 lots.
- After 18 months, your account is up to $233,035. You are trading $568 lots. Holy crap!

Now, you will have had to pay taxes once by this point, decreasing the overall amount. But you get the picture. After a mere 18 months, you have earned enough money to quit your job and live off your trading income.

The high leverage offered to forex traders is what makes this kind of compounding possible. In no other market can you trade for this little, yet walk away with so much. What's more, if your greed gets the best of you and you screw it all up (which I have done), it does not take all that much time to recover your losses. This is why forex is the best market for the small trader, as opposed to equities or even futures, where the leverage is much less. Keep your goals realistic, *stay disciplined*, and financial freedom is within your grasp.

RULE: Your initial trading stake should be small

As demonstrated above, a small initial trading stake grows by leaps and bounds in a short period of time. It is therefore unnecessary and even unwise to start with a large amount of money. I recommend that the beginning trader start with no more than $2,000. Even $500 is fine. The losses you experience will be small and easier to handle psychologically. If you start with $10,000, your small losses will amount to around $200, which is more difficult to take if you are unprepared for this eventuality. You will then be tempted to overtrade in order to recoup that loss, and soon you will be down $1,000 or even more. While such a loss is recoupable in a relatively short period of time, there is no reason to set yourself back a week or two unnecessarily.

If you have experience trading other markets, you are probably fine starting with more, but not much more. And if you do start with more, it should be an excuse to trade *less.* The larger your account, the fewer pips you need to make on a daily basis to achieve your long-term goal of living off your trading income. Even a more experienced trader ought not to be trading mega-lots from the outset.

RULE: Do not enter a trade without a profit target

Not only should you have a daily target, but you must also set a target for any given trade and then *stick to it*. (Again, this applies to the intraday trader. Swing traders ought to look for 100+ pip gains, and should not limit themselves with an arbitrary target.) Only by doing this can you compound your winnings.

Only if you have objective confirmation that the market is going to travel beyond your profit target should you continue to hold your position. And then, you must watch your position like a hawk, exiting as soon as that objective confirmation no longer exists.

RULE: Always set a hard stop

Some traders think that their brokers are out to get them, and refuse to put hard stops on their trades. Whether or not this is the case, you need to put a hard stop because one day you will lose your internet connection, and who knows what will happen in the market while it's down? I guarantee that it will happen. Stop losses preserve your capital.

Some time ago there was a morning where I was in a trade when the GBP/USD was particularly volatile. I lost my internet connection, forgot to put a stop, and at 7:30 am the internet café near my house had not yet opened for the day. Ack! You can imagine the panic I felt. I got in my car with my laptop, hoping to find a café with wireless internet access. Then I remembered: I could use the public access computers at K-Mart. That's right, K-Mart! I swear, it is true. I logged on and closed out my position at a gain of 1 pip. It was disappointing, because I would have made 20 pips if I had been present to manage the trade. But I knew that I had been lucky to exit with any profit at all. Attention, K-Mart traders! Set your stop.

You need not set a stop at the actual price you intend to exit. In fact, I do not recommend this because of the insidious stop-hunting practices of bucket shop brokers and big money traders. (The pre-London open time between 6-8 am GMT is particularly dangerous in this regard.) Your stop should be well away from the market at 20 pips. This is a far enough distance such that the chances of a stop runner rally taking out your position are very small. But again,if you are an intraday trader, you should not let their position go more than 10 pips against you. If it already went against you by that much, there is a good chance that it will keep going against you. By this point, you are surely asking for it.

I also think that a larger stop is counter-productive. Firstly, you are losing money when you could have made money by reversing your position in accordance with what the market was actually doing. Secondly, when you hang on to losing trades, you are not in a winning mindset. To hope is to set yourself up to lose. Trading to win means trading smart. You must accept that losses are inevitable, and keeping your losses small allows you to stay capitalized for the next opportunity.

RULE: Do not trade unless you are nearly 100% certain about what will happen

Why else would you take a trade? It's your money. Don't you want to (a) keep it, and (b) make it grow?

It is amazing how we as traders will stretch the rules for our setups just to get in. We never want to miss The Move. But if it is The Move we want, then we must *wait* for it.

Whatever system you use, follow it. Do not bend the rules.

RULE: Do not trade when signals are mixed

Let's say you use the slope of a moving average to gauge whether the bias is long or short, and a stochastic indicator to time entries. (NOTE: This is merely an example, and not a recommendation to trade such a system.) The moving average is pointing downwards, but the stochastic lines have crossed up from oversold. What do you do? The answer is *stay out*.

We must always wait for the best setups possible if we are to succeed in this business. This means trading according the rules of your system and not taking a trade when indicators are unclear as to what to do, which ought to be taken as an indication to *do nothing*.

RULE: Follow your system

Do not deviate from your normal trading plan and jump into trades just because they look enticing for whatever silly reason. You should also avoid trades that can be justified by other traders, but which do not fit with your existing system. Doing this will screw with your mindset and jettison your capital. New ideas ought to be tested in a demo account, or by going back in time on a chart.

Your system must be formalized. Write down the sets of rules that comprise your entry triggers and always have them near your trading station. And then stick to them like a magnet.

RULE: Don't lose your head

Letting your emotions get the best of you is a recipe for disaster. Some examples of emotional trading are these:

- *Jumping into a trade, without having thought about whether it conforms to clear, objective criteria for taking a trade.*
- *Exiting your trade too early because you are afraid to lose money.*
- *Hastily reversing your trade to get on the "right" side of the market*. You should have rules governing when to reverse. A clean exit is always preferable because it gives you the extra time to make sure that taking the opposite trade is the correct course of action.
- *Taking a trade immediately after a loss*. This is revenge trading. After a loss you must evaluate where you went wrong so that the next trade has an excellent chance of being profitable.
- *Taking a trade immediately when you sit down to trade*. Hooray, the market is open! Let's trade the first thing that moves! This is sheer madness. Take 15-30 minutes to gauge what the market has been doing, and then *wait* for a trade. You must get in sync with the market before you take your first trade of the day.
- *Fudging your setups to get in a trade*. Again, only a proper setup defined by objective criteria warrants taking a trade. If you're fudging, you're wishing and hoping. These are two emotions that you must get rid of if you are to succeed as a trader.

RULE: Identify key support and resistance levels

Support and resistance are the founding concepts of technical analysis. Any trading that we do based on charts must be informed by our knowledge of the price levels at which the market has either stopped or reversed. Without this knowledge, we are flying blind.

Support and resistance can be used to identify profit targets for trades, and also potential areas where a trade might occur. For instance, one might wait to see whether the market will break out from a key level, and then trade the breakout. Or, one can trade the bounce off a level once the market has been repelled by an overabundance of supply.

There are many resources on the internet where one can learn about support and resistance levels and how to find them. Seek out these sites, and then apply what you have learned to your trading.

RULE: Look at longer timeframes for both support and resistance, and for clues regarding future price direction

A short-term trader may prefer to trade based on fifteen, five, or even one minute charts. However, it is necessary to go to at least an hourly chart to determine the longer term history of the pair. Even a scalper can benefit from knowing what the pair has done in the last week or month, where both price patterns and the character of the market are revealed. Without this knowledge, you may miss trading or profit-taking opportunities.

RULE: Be aware of peak market times

The website http://www.worldmarkethours.com will provide you with the countdown to all opening and closing times in the major financial markets, forex included. The most active times in forex are 7-10 or 11 am GMT and the morning portion of the New York session, which overlaps with London afternoon. London becomes very active around 8:30 am GMT, and New York typically has a good move at 2:00 pm GMT. The afternoon portion of each session sometimes yields good trades, though more often than not the market is range-bound. Still, any market that is moving can at least be scalped, and if you can scalp successfully, you don't need to do that much more. Whenever you prefer to trade, stay out of illiquid markets, characterized by little movement or unpredictable movement. You can't trade a market that doesn't move, or moves in a manner that renders the rules of your system all but useless.

RULE: Be careful when trading in the Asian session

Prior to 12 - 1 am GMT, the Asian session trades thinly. There are few real players in the market, and there is a lack of currency-related news during this time. Currencies either trade in tight ranges that make for poor trading opportunities, or whipsaw up and down with sudden changes in liquidity. It is easy to lose money during this time. Every once in a while there will be a surprise news announcement, and the market will move dramatically. But it an infrequent occurrence.

I have found that the USD/JPY is the best pair to trade in this market, followed by the volatile yen crosses (GBP/JPY and EUR/JPY), and finally EUR/USD. Some like to trade the AUD/JPY when the Sydney and Tokyo sessions overlap. But the nature of this session is such that profits must be taken quickly. I actually advise that you avoid trading during this time unless your day job makes it impossible for you to trade the London or New York sessions. If you remember that only a few pips a day is needed to ensure successful compounding of one's account, then trading the Asian session is certainly viable. A strategy geared toward scalping the USD/JPY between the hours of 12 to 3 AM GMT can be devised to this end.

RULE: Don't trade thin or directionless markets

You can tell when a market is thinly populated by the lack of movement on the chart, punctuated by sudden whipsaws up and down. A slow market is tradable so long as there is a 20-pip range between swings. But a market that does not move is not one in which you can profit. If the candles are small and barely moving, stay out.

By the same token, the fact that a market is active does not mean it is tradable. If you have one candle up, then another down, then another up, and so on within a narrow price range, you have an untradeable market. The only market participants who make money in this time are brokers. Wait for a clear trend and trade only then.

RULE: Be careful when trading forex on non-news days

The sentiment of the market is largely attributable to traders' reactions to fundamental economic news releases. On days when there is no news, there are far fewer big-money traders in the market. Bank traders are guided by fundamental data in deciding which side of a position to take, and well-capitalized professionals who are not bank-affiliated nevertheless trade as if they were bank traders, i.e., by following the big, institutional money. When there is no news, the market tends to drift aimlessly because the serious money is, well, serious. Big trades are taken only if the fundamental data can influence market sentiment to an extent that it will move the market significantly. Thus, days without news are typically bad news for the small trader. Thinly populated and without any clear direction, it is easy to take numerous small losses in a row trying to guess the next move, which never seems to come.

When there is no news, you are likely facing the kind of thin, directionless market discussed in the previous rule. When there is little volume in the market to support any semblance of a move, technical trading systems will give many false signals. Unless you see unambiguous evidence of a move, stay out. And when you do find yourself in profit, take your profits quicker.

It is better to avoid trading on these days altogether. The good days will more than make up for your non-participation on these dead days. And there are thousands of things that are more fun to do than trading an untradeable market. Hopefully you have a hobby or two besides trading. If you don't, now is the time to acquire one. (I play the guitar.)

RULE: If you trade intraday, don't enter a trade unless you can actively focus on it

If you trade off 5- or 1-minute charts, it is not safe to enter a trade unless you can actively monitor it. Take bathroom, coffee, and food breaks between trades so that you can be completely focused on your trade while you are in it. At the most, a 15-minute trader can go for a quick coffee break after entering a trade. If you can't stand this, then trade on hourly or higher charts, which will free you from your computer. Whatever timeframe you trade, arrange your schedule such that you can manage your trade with an eye toward exiting profitably.

RULE: Avoid reversing trades

In most cases, reversing a trade is an emotional reaction to a trade gone bad. You should exit the first trade cleanly and then pause to consider whether taking a trade in the opposite direction is justified by the rules of your system. That pause can do wonders for the preservation of the capital.

RULE: Stay out of the market near news release time

At the minimum, you should exit all trades five minutes before any major news release. If it is Non-Farm Payroll, you should stay out of the dollar-paired currencies *several hours* prior to this event, for the market is either very thin or prone to sudden jerks as traders try to position themselves in anticipation of the numbers. Moreover, certain brokers widen their spread just before news time, which can increase your loss if you are already behind.

Do not trade the spike in price at the release of the numbers unless you have access to a professional news feed. Such feeds are beyond the means of most small traders, costing $1400 or more per month. There are plenty of opportunities to trade without gambling on the news spike, or worse, speculating on which direction the numbers will favor. This is gambling, not trading. By contrast, there are plentiful opportunities to trade after the initial news release. When the numbers are particularly strong, there will often be a pullback and then a second move in the direction of the initial spike. You can trade this second move using some form of a retracement strategy.

The website http://www.forexfactory.com has a calendar of news releases. Consult this daily and make note of when the news times are. British news time is almost always 9:30 am GMT and American news comes out at 1:30 or 3:00 pm GMT, depending on the event. There is also the occasional Australian or New Zealand news, which can move the markets in those countries' currencies.

RULE: Watch your broker like a hawk

Forex is a non-regulated market. Unlike a stock exchange, there is no central authority regulating the bid and ask prices for a given pair. The "market" price is a function of the party-to-party interbank transactions of massive proportions made by bank traders. Everyone else plays second fiddle.

Small traders who wish to speculate on currencies must trade in the secondary "retail" forex market, which is purely a function of the trader's broker. This is why most brokers are able to offer a fixed spread. The "market" is not the real interbank market, but one of their own devising. For all intents and purposes, most brokers are the computer age version of a 1920s style bucket shop, taking the other side of their customers' trades and manipulating the market in their favor. The larger trades are hedged in the interbank market—when you go long, so do they. In the end, the difference between their customers' winning and losing trades is cancelled out, and all profits are made from the spread and also the shady practices of market manipulation and stop-running. It is because brokers have to hedge much of their risk that the price on your screen is close to the interbank price. But it is the only reason; there is no legal requirement that your broker's quote must match the one supplied by the banks to their in-house traders.

I have seen these practices with my own eyes. With two broker platforms open, I once saw the price of GBP/USD shoot down 10 pips at one broker while the other platform did not change. Sometimes when placing an order, you will get a "requote," where the market has moved after you clicked buy or sell, and the broker's platform asks whether you want to accept the new price. Meanwhile the pair is moving and you are losing out on profit, or possibly seeing a profitable position you wished to close turn unprofitable. In the stock market, by contrast, a market order to buy or sell gets filled whenever you click.

The only broker that does not requote their customers' orders is Oanda. This is because every order that is placed on their platform is hedged in the real interbank market. The tight spreads they offer reflect institutional interbank prices. However, the downside of trading with Oanda is the variable spreads. Before and after news events, the spread between the bid and ask price will widen to as much as 15 pips to reflect the spread that Oanda is being charged by the banks with whom they hedge. The spread will also widen during slower trading periods.

Research your broker thoroughly. There is no one perfect broker, and you are bound to experience some problem with your trades at some point. It is simply a cost of trading retail forex. If you get bad fills, telephone your broker immediately and demand that you be filled at the price where you clicked. (And use the phone, not e-mail.)

When you have built your account to over $100,000, you can leave the retail forex world behind and trade the real interbank market using an interbank platform. There is also the promise of centralization in the near future. Reuters and the Chicago Mercantile Exchange have announced the formation of FXMarketplace, the first exchange-like setting for the trading of “spot” currency. Though it will not be offered to retail customers directly, one can hope that brokers will offer this service to customers at the cost of a commission. This will be a most welcome event when it finally does happen.

RULE: Don’t go crazy with leverage

With some brokers offering 400:1 leverage, one can control a position worth 400 times the value of their account. Thus, if GBP/USD is trading at $1.97, a trader with $2000 in his or her account can buy 4 standard lots, where each pip is worth $40. If the trader incurs a 20 pip loss, $800 is gone, nearly half the trader’s account.

As Susan Powter used to exclaim, “Stop the insanity!” As a beginner, 50:1 is probably the highest you can leverage yourself without running the risk of ruin. Even bank traders do not leverage themselves nearly this high, going for about 10:1. As small traders, we ought to take advantage of high leverage, but not to the extent that we are done in before we have even begun to implement our trading strategy. Don’t let your greed get the best of you. If you use leverage reasonably, you will make out handsomely. But lose your discipline, and you can forget about compounding your account.

RULE: Stop trading after two consecutive losses

The best way to avoid a losing streak is to stop trading once you have suffered two losses in a row. Take a break, shut down your trading station, and leave your home or office, or at least leave the room. These actions are crucial in order to avoid getting into a losing mindset with its overtrading, revenge trading, anger, and eventual apathy and depression. *You must physically break with your trading environment.* Do what you have to do to feel better before going back to trade.

RULE: Take profits quicker after a losing streak

It is difficult to build one’s confidence back after a string of losing trades. The best way to do this is by executing a series of small winning trades. Whenever you are in a winning trade and it appears as if the momentum has stopped, take your profit. If it's only a few pips, fine. You will be surprised at how much better you feel once you have a few winners under your belt.

RULE: Don't gloat over your winners

It is great to win. But it is not an event over which you should marvel. When you win a trade, you are doing your job well. But it is not cause for celebration. If you have met your daily profit target, shut down and get on with your life for the day. The more you salivate over and brag about your winners, the more overconfident you will get, and sooner or later you will have your comeuppance. Remember: the market giveth, and the market taketh away.

Another thing: bragging to other traders about how many pips you made is in very poor taste. Again, it's great to win. But winning should be the normal state of trading, not the exception. When you make your wins out to be exceptions to the rule, they inevitably will become so.

RULE: Be wary of chat rooms and online forums

For the most part, the online world where traders congregate is full of braggarts, wannabes, leeches, and crooks. Use common sense to separate the wheat from the chaff.

Any online forum is bound to have its bad apples, but there are inevitably a few intelligent people who will post useful information. Just be circumspect about who to trust and what to believe.

RULE: Don't buy systems

Think for yourself. No system out there is flawless, and with a little hard work you can devise a system that is just as good as anything for sale.

Beginning traders flock to vendors, enticed by the song of so many pipped-pipers. Well, you know how that story ends. To succeed as a trader, you must work to educate yourself. Do buy or borrow books on trading and study them carefully (see the recommended reading list at the end of this document). Even certain online trading courses can be worthwhile, so long as you perform investigate the quality of the training first. But don't buy a system expecting a pip machine. You must adjust to what is going on *now*, and no one system will succeed at all times. For a set of rules to apply, there must be a set of market conditions in place such that the rules will work. Thus your system must do two things: identify the type of market (trending or range-bound), and the rules to trade that market. If it is a range-bound market, be aware that even in this environment, there exist micro trends or a general bias to the long or short side. You must pay attention to the market's short- and long-term biases at all times.

By the same token, there are many *free* systems out there that are fully published and commented upon. I personally recommend, again, forexfactory.com. The forums there are the best around, and there are some very sound trading systems that you can adopt and make your own.

Rule: Stay healthy

To maintain the focus required to trade effectively, you must not be hungry, tired, anxious, or depressed. The sleep issue is particularly problematic due to the 24-hour nature of the forex market. You must take care to get the rest you need. You are not superhuman. Everyone needs to eat and sleep regularly to function properly.

If you have suffer from anxiety or depression, trading-related or not, seek professional help immediately. Effective trading is not possible when you are not thinking straight, and these conditions are marked by hazy or agitated thinking.   Moreover, the self-doubt associated with depression is not conducive to the winning mindset that you need.

Finally, if you find yourself trading compulsively, you might have a gambling problem. If this is the case, you should seek out Gamblers' Anonymous, and perhaps pay someone else to trade for you.

Rule: Don't give up

If you are not a tradeaholic and you are discouraged by your lack of success, consider that even the most successful traders tell stories about their early days of trading and how bad they were. Trading is a skill and it takes time to hone that skill. More than anything, trading is about discipline and money management. It is actually not difficult to take 5 pips from the market every day. The difficult part is keeping to your trading plan and exerting the self-discipline to not trade when there is no reason to do so, either because you have met your profit target for the day, or because a trade setup is not there.   If you can master this part, you are guaranteed to be successful. You will see trades coming to you, instead of hiding from you as you furtively scrounge for pips. Leave the scrounging to others, and stay focused on trading, *not as an end in itself, but a means to the end of freedom*.   That is what this is all about. We trade to live, and for no other reason. Remember this.

Suggested Reading

<u>For New Traders</u>:

Alexander Elder's *Trading for a Living* is an excellent trading primer and the first book you should read. You should also purchase the accompanying *Study Guide for Trading for a Living.* His newer *Come Into My Trading Room* is also well worth reading. It contains a revamped section on trading psychology, in addition to updating some of the trading concepts elucidated in his first book.

Jack Schwager's *Market Wizards* and *The New Market Wizards* are must reads. They contain interviews with top traders. Highly educative and entertaining. You can read these in conjunction with Elder's book. In particular, the interview with Bill Lipschutz in the second book provides great insight into the real forex market, where bank traders move billions on a trade.

When you have worked your way through these, Kathy Lien's *Day Trading the Currency Market* is a good general introduction to forex. Be wary of her trading setups, however.

The anonymously authored *Stikky Stock Charts* is about as fun a book on trading you will read. It is also a great primer on chart patterns and trendlines, which you must know. Though the focus is stocks, charts are charts.

Rob Booker's books and websites are excellent. His new book, *Adventures of a Currency* Trader, is a delight.

<u>Intermediate Books – focused on trading tactics and techniques</u>

Marcel Link's *High Probability Trading* is a good technical trading book.

Steve Nison's *Japanese Candlestick Charting Techniques* is a must. Well worth its price.

John Person's *Candlestick and Pivot Point Trading Triggers.* What the title says.

Igor Toschchakov's *Beat the Odds in Forex Trading*. This is the best book on trading forex I have read. Erudite, with some very interesting trading setups.

<u>Advanced</u>

Bernard Baumohl's *The Secrets of Economic Indicators*. For knowledge of fundamentals.

Thomas Bulkowski's *Encyclopedia of Chart Patterns.*

Thomas Demark's *The New Science of Technical Analysis.* Difficult reading. Excellent material, particularly on price projections and Fibonacci analysis.

Not recommended:

Boris Schlossberg's *Technical Analysis of the Currency Market.* As knowledgeable as the author is, this book contains dubious and confusing trading setups.

James Dicks' *Forex Made Easy: 6 Easy Ways to Trade the Dollar* is the worst trading book I have ever read. Sheer garbage. And from what I have heard, you should not buy the $3,000 course either.

Websites:

http://www.forexfactory.com – for news release information

http://www.dailyfx.com – "expert" market commentary ☺

http://www.mataf.net/en/analysis-correlation.htm - data on correlations between currencies

http://www.babypips.com – basic forex knowledge

http://www.freecotcharts.com – commitment of traders (smart vs. dumb money)