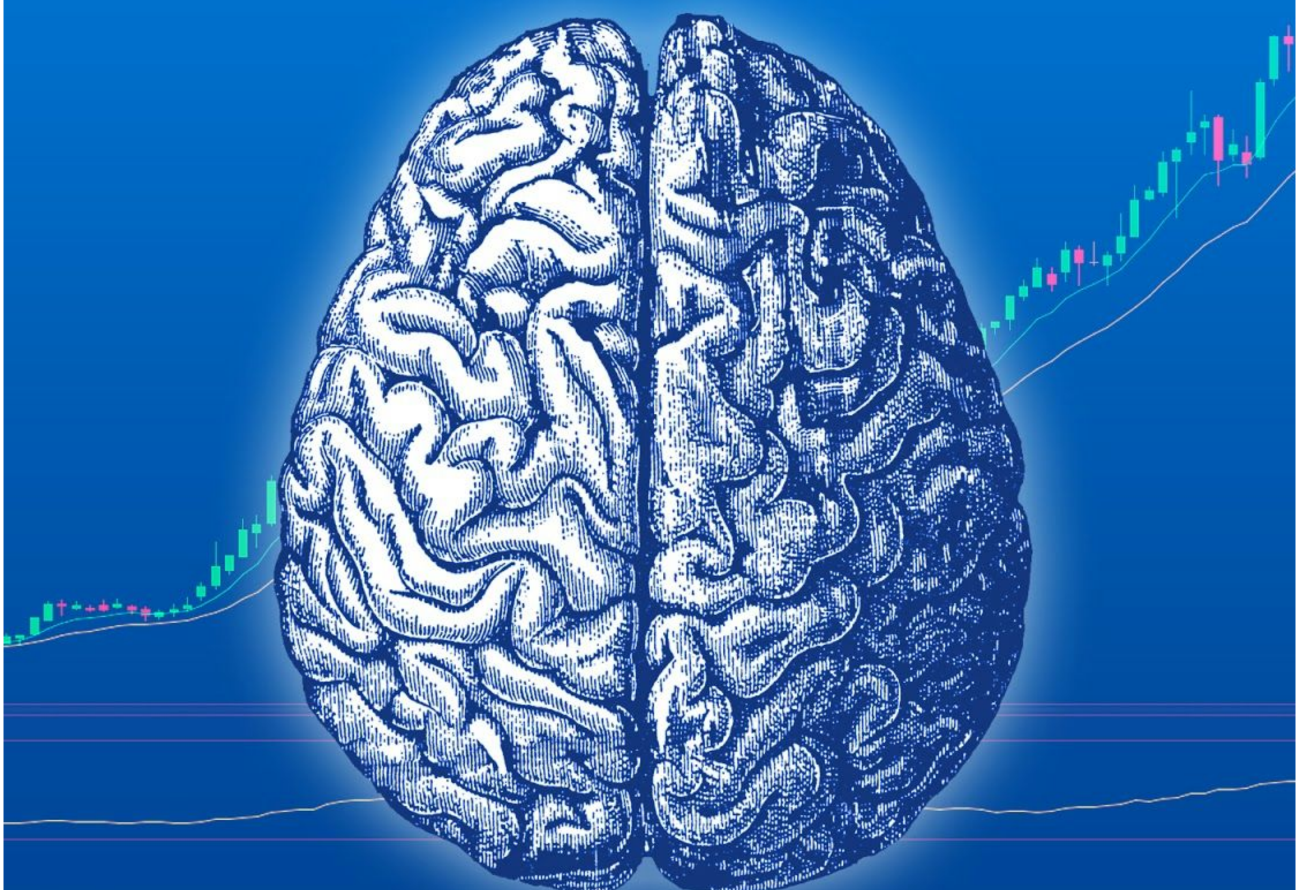
INSIDE A TRADERS MIND

13 LAWS ALL TRADERS SHOULD LIVE BY



written by
TRENDS OF TRADING

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Introduction

Whether you are a beginner or a seasoned trader there are a certain set of laws you should live by when trading. I know you have probably heard this saying more times than you can count "IT'S 90% MENTAL". This old saying pertains to most things in life and probably is as relevant to trading as anything else in the world. It is important to have the correct mindset at all times if you want any longevity and success in the business of trading the markets. Trading is beautiful in many ways, yet it is often a lonely profession. It is you against the markets and even more so, it is you against you! Having the proper framework is a pre-requisite for profitable trading.

Think about it like this - A car cannot be built in a factory if machines are not programmed a certain way first. A trader's mind needs to be programmed as well. I put together a list of what I believe are indisputable laws which are essential to follow for anyone who is serious about the markets. If you dissect the brain of any successful trader I believe you will find these laws embedded inside them. Learn them and most importantly ***commit*** to following them every single day.

1 - Have A Game Plan When Trading… And Stick To It

Your first step to being a successful trader is developing your game plan. This is your blueprint of how you will approach and navigate through the markets every day. **“Write it down”,** and consistently review it. Be as detailed as possible when writing out your trading plan.

Your answer to each of the following questions should be your trading game plan:

- ## What is your identity as a trader?

  All traders should have one. Are you a Scalper, Day-trader, Swing-trader, Trend trader, Long term investor? It is ok if you trade more than one style, just specify so in your plan and not week to week as you trade. Also, are you a long only or short only trader, or will you trade both long and short?

- ## What markets will you trade?

  Money can be made trading stocks, futures, forex, options, bonds etc. It is best to focus on specific markets to trade. If you are an equities trader then identify specific types of stocks you will trade. An example of this would be focusing on:

  - Small cap stocks under $10 a share
  - Gold and Oil Futures
  - Stocks between $10 & $50 a share; at least mid-cap in size with an average daily volume of at least 1 million shares

Be as detailed as possible. You can narrow it down by any criteria you may like. Find what fits your personality and trading style best; stick to it! It can be difficult trying to hop around day to day and is not necessary.

- **What trading strategies will you use?**

Keep it simple. Pick out a few key systems and stick to them. A trader can be successful with only 1 trading strategy. I believe it is important to have a few that you use. Keep the rules as simple as possible. You should be able to write down the rules of your trading system on paper the size of a cocktail napkin. Know exactly how you will enter each trade.

***Make sure you do extensive testing on a new system before you go live trading it.**

- **Risk And Position Sizing Method?**

This is critical and the first step in controlling your risk when trading. Setting your risk and position size go hand and hand with each other. Know how much money you will risk per trade. Your goal should be to risk the same amount of you trading capital on every trade that you take. Base this on a percentage of your overall trading capital. Don't overtrade and risk too much money on any 1 single trade.

Next would be to set the size of your position. Professional traders put a strong emphasis on proper position sizing. After you determine how much capital you will risk on a trade you can set your position size. Base this on the current volatility of whatever it is that you are trading. A more volatile stock should require less of your capital; and more capital should be allocated to a stock with lower volatility. **Use Average True Range to measure volatility.*

An example of this would be:

- $100,000 of trading capital
- 2% risk = $2000 per trade
- Volatility tells you to risk $4 on trade
- Buy 500 shares

It is very important to have these parameters set in your trading plan. Many people overlook and underestimate knowing in advance exactly how much money they will risk on a trade. Also, a lot of traders operate without a consistent method when setting position sizes. Knowing what you will risk on a given trade and how to set your positions is an important step to ensure that you will have a long career trading the markets.

- ## What is your exit strategy?

There are 2 parts to this. You need an exit strategy when things are working and when they are not.

First, you need to make sure you protect your downside on each trade. Stop-losses should be used **EVERY** single time no matter what. Your parameters on how you set your initial stop-loss should be set in advance. There are several different methods to use and they are all ok. The important thing is to pick one. Protecting your downside is the most important thing when trading. Never, never remove or disobey a stop-loss. That is a recipe for disaster when trading.

Second is how you will take profits. Have a specific way of locking in your profits. Whether it's a specified price target or by using a trailing stop loss. Make sure this is determined before a trade is put on. If you try and decide when you should take a profit when you are already in a trade, your emotions will take over. Fear of a winning trade becoming a loser or greed of wanting to make more money will impact your decisions. Your goal is to trade with as little emotion as possible so, have your exit strategy firmly set before entering a trade.

Having a strict exit strategy in place also reduces the time you need to be sitting glued to your computer screen. Starring at your monitor after a trade is put on will never make you more money. By having these details worked out you can simply put a trade on; set your exit parameters and that is it. **Let the market be your best employee and do the work for you!**

- **Are there any specific occasions when you will not be trading?**

An example of this would be day-trading on a Fed day, or putting a swing trade on very close to an earnings announcement. Some traders don't like to have risk during holidays as volume might be light. Maybe at certain times of the year when you have a lot of other things going on in your life. This is a very personal part of your trading plan that is specific to each trader. Take some time and think about this one, as it can save you a lot of money in the long run.

- **How will you track each trade?**

Have a way that you will track each trade you take. This is simple but worth doing. It is great to take time each month and look back to review your trades. This is how you can make sure you have been executing according to your game plan. Make a spreadsheet and include:

  - Date
  - Market or stock traded
  - Entry price
  - Risk
  - Exit date
  - Exit price
  - Profit/Loss
  - Notes on the trade

- **You can include anything else in your game plan that you feel is important to your trading success.**

A strict game plan is a trader's biggest ally. By having one, you take the guess work out of trading. The key is to be mechanical as possible at all times. **Trust and believe in your plan**. I can't stress this enough! Always remember that if you do the work, the profits will follow!

2 - Control Your Emotions At All Times

Trading is 90% mental. Psychology plays the biggest part in being a professional trader. This is what separates someone who has long term success as a trader from someone who will constantly blow their account up by letting their emotions dictate their trading. Trade without fear, greed, panic, laziness, anxiety, cockiness, stubbornness. Leave your pride at the door! Never revenge trade because you took a loss and **NEED** to make it back immediately. Never get frustrated when trading.

Learn to trade with confidence and trust what you are seeing in the markets. Doing your homework and being prepared for anything the market throws in your direction will let you trade this way. Trade with perspective of what you are looking to accomplish on each trade, and in trading overall. Believe in yourself at all times and have a positive attitude 100% of the time.

Understand the good and bad emotions and how they affect trading. Learn to temper and control these emotions when they flare up. Learning to trade like a machine and detaching your emotions when trading is the most valuable thing you can ever do. **Be ready to execute on your game plan emotionless.**

3 - Stay Discipline And Think Objectively

Although these fall under the category of emotions, they deserve their own law. As I said earlier, psychology is the biggest part of being a successful trader. Being discipline and thinking objectively are the most important parts of the psychology behind trading.

Just like in life, all long term successes are because of a consistent disciplined approach. Be committed to sticking to your game plan. Do your homework and be prepared. Be consistent in your approach and your execution. Stick to your stop-losses and your profit targets. Don't try and cut corners because the market will sniff this out and crush you. Above all, if you can stay DISCIPLINED, DISCIPLINED, DISCIPLINED 100% of the time, you will be two steps ahead of the game.

The best way to control your emotions when trading is to learn to always think objectively. Professional traders understand that this is key to winning in the markets. Don't have a pre-conceived notion that the market or a stock should do a certain thing. Thinking objectively means you are simply looking for the best possible opportunity when looking at the market. Objective thinkers do not want certainty; they want good opportunities. Read the charts and listen to what price action is telling you, then Act. Being objective means you have a free and clear mind and not feeling any pressure. It is a beautiful state of mind to be in. **Remember as a trader, the consistency you seek should be in your mind!**

4 - Don't Trade Just To Trade

This is a very important lesson that all traders should learn as early as possible. Only trade when you have a clear and distinct reason to do so. Don't trade because you want to put on a position or take one off. Don't buy a stock or a market because you like it or sell another one because you don’t like it. If you like the product of a particular company, go buy the product. It doesn’t mean you need to own the stock. Never sell something because it is up big or buy because it is down big. Don't put a trade on because you think a market or stock is DUE to do something. This is never the case.

Drown out the noise of news headlines and any other silly thing that you hear. Doing nothing is often the best action to take, and also sometimes the hardest thing to do. Be patient and know that money is made in the market by sitting on your hands, not by using them. The only time to take action is when your game plan calls for it. Stick to your specific systems and trade parameters once a position is put on. By following law #3 of staying discipline, this should be an easy rule to follow. Be a machine! **Trade to win, don’t trade just to trade.**

#5 - Never Think About Money When Trading

If you focus on making money you will lose money. Your emotions will get involved and hinder your ability to make the best decision possible. Of course your goal as a trader is to make money but that shouldn’t be your focus. Focus on trading correctly. Think of your game plan, the process, think objectively. As a trader your only focus should be on flawless execution of your game plan. It’s very simple. **Profits are a by-product of you trading correctly**. Trade to trade correctly and the profits will follow!

#6 - Winning Percentage Means Absolutely Nothing

How often you win or lose is insignificant. What's important is the size of your gains compared to the size of your losses. The best traders of all time are right only about 50-55% of the time. The difference is how they control their risk on a losing trade, and how they maximize their gains on the winners. Too many traders try and think they should be right every single time or have a winning percentage of 85% to make money in the markets. This is what often stunts the growth of new traders.

You can be right 35-40% of the time and make a killing in the market if the relationship of your gains is in correct proportion to the size of your losses. It is human nature to seek perfection and the fact of consistently being right but it is not necessary in trading. There are so many different factors at play every day in the market that make an 85% or higher winning percentage unsustainable. Having big wins is important. To sum it up; **LOSE SMALL AND WIN BIG!**

7 - Lose Like A Professional

A major key to winning in the markets is knowing how to lose like a professional. As a trader you need to control your risk at all times. Professional traders lose often, sometimes more frequent than they win. However, they lose the right way. To lose like a professional you should:

- Cut your losses and keep them small
- Always use a stop-loss
- Admit you are wrong quickly

- Accept your losses and move on
- Forget about a loss immediately after you take it
- Understand that losses are part of trading

Losing streaks will come but the key is to preserve your capital as much as possible. You want to last in the business of trading for the long run. The only way to do that is to lose the proper way. Taking a loss is a normal thing in trading. If a trade is not going in your favor, a loss will free up your capital in which you can put on a different position which can be a winner. This is how you should think when it comes to taking losses.

Look at taking a loss as a good thing because you stuck to your trading plan and executed when you should have. Taking losses when trading is a very easy thing to do if you are discipline. Always remember that winning is born out of losing. **Lose like a professional!**

#8 - Let Your Winners Run

Staying consistent with the previous laws we detailed, you should always let your winners run. To make money in the markets you need big wins. When in a winning trade, let it run. Again, being discipline and trusting your game plan will let you confidently do this. Tell yourself that you are right in your thinking and ride that profitable trade as long as possible.

I believe the best way to let your winners run and maximize your profits is to use a trailing stop-loss. This is also the emotionless way to let your winners run.

Having a trailing stop in place and having a winning trade run and run is what traders live for.

"*Never question how far a stock or market can go in one direction, up or down*"

#9 - Cash Is A Position, And A Good One

Remember you don't always have to be invested. You can be long, short, or in CASH. If there are no good opportunities out there, it is perfectly ok to be in cash. Often, the best trade is doing nothing. If you are not comfortable, or are not seeing things clear just move to the sidelines. When volatility picks up or things get extremely choppy, cash can be the best position. If you ever feel your emotions are getting the best of you take a break from trading.

As a trader, your most important job is to protect your capital at all times. **Be like an army general guarding his troops.** Only deploy your capital when the time is right. Your goal is to have a long trading career and remembering that cash is a position that will help you last.

#10 - Follow The Path Of Least Resistance

"A stock is never too high to start buying, or too low to start selling."

Never fight the market or the prevailing trend of a particular stock. Don't try and be a hero. Calling tops and bottoms is a losers game. That old adage of buy low and sell high sounds good in theory; but should have been used as a bumper sticker. There is always a reason why a stock is running away, or falling out of bed. It is not necessary to get in at the exact bottom and out at the top tick. As a trader you want to capture the meat of a move.   Recognize the path of least resistance and trade in that direction.

11 - Prepare & Educate

A disciplined trader who is focused to his craft and mastering the art of trading not only follows this law but loves it! As with anything in life, you should always be prepared and continuously educate yourself. Do your homework. Never trade on the fly and think you can show up five minutes before the market opens and be ready to rock and roll. The importance of doing the homework and being prepared can be summed up two fold.

- You will be much more relaxed when trading
- When opportunity presents itself you can put the trade on without thinking; set your trade parameters and let the market do the work for you

"BEING PREPARED MAKES YOU ACTIVE AND AGGRESSIVE WHEN YOU HAVE TO BE IN THE MARKETS"

Always keep educating yourself. You should enjoy this, not dread it. You're a competitor just like any athlete out there. Act like it! Read books on trading and self- development. Always review your trades after they are done. Test new strategies and learn to optimize your execution. Your goal as a trader should be the same as your goal is in life…**To get better every single day than you were the day before.** The market favors the prepared mind so always do your homework and never stop educating and developing yourself. Trading is an art that is never fully mastered; just built upon!

#12 - Remember Why You Trade

Find your motivation and keep it with you everyday while trading. Think about what motivates you to be a successful trader before the market opens each day. Sure, trading is a beautiful thing and enjoyable but a professional trader knows it is not a game. With that being said, there has to be a greater reason other than trading that pushes you to success. Just like profits are a by-product of you trading correctly; I believe trading is a by-product of a greater goal. Find your motivation and keep it in your mind at all times. This will help you stay more disciplined when trading.

#13 - Focus On What You Can Control

There are certain things you can control when trading. This is what you should think about and focus on. You can and should control:

- Your risk at all times
- Your emotions
- Your execution

Always respect the power of the market and your trading capital. Building your capital is like building respect. It takes years to build but can be destroyed in seconds if not treated properly. Remember that you are not bigger than the market and your opinions mean absolutely nothing. Be objective and commit to having flawless execution of your trading plan. You should also understand that the market is in perpetual motion. This means it is constantly open and you can always put another trade on. Control your time in the market. Make sure you understand what you can and can't control in trading. Control your approach and the process in which you operate. The market controls the rest.

Final Thoughts

As you can see, all of these trading laws go hand in hand with each other. For the most part they tend to focus on a few key topics. Stay disciplined… Be prepared… Have a plan of action… and most importantly, be in the right state of mind when trading. Protecting your capital is as important as making money. Study these laws and constantly pause and ask yourself if you are following them at all times. Hopefully these 13 trading laws help you to develop a better mental edge when trading. Keep them with you through every step of your trading journey! Lastly, I will say that trading is a beautiful form of art and should be *loved* by anyone who attempts to profit from the market.