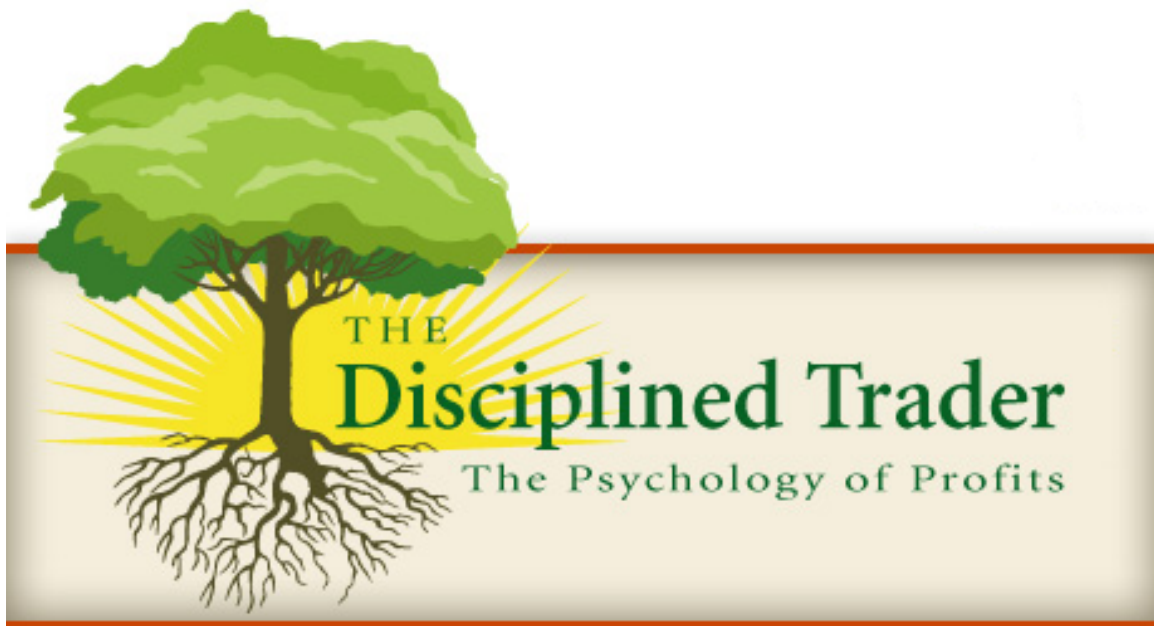


Building and Following Your Trading Plan:

Conversations with Vadym Graifer

Fall 2010

presented by:



We were proud to have Vadym Graifer as a Guest Administrator for our forum on "Building and Following Your Trading Plan". He is know as an expert Tape Reader (it's an old-school art) ... but I know him as an expert in Trading Plans ... and you will too.

Vad is the author of several trading books, including "The Master Profit Plan", on the topic of Trading Plans.

<http://www.realitytrader.com/masterplan>

I own it and you may want to, too.

Students of '[The Disciplined Trader Intensive Program](#)' got to ask Vad One-on-One questions about creating and implementing their trading plans. The following is a compilation of the those Question and Vad's Responses. Please allow Vad's knowledge to contribute to your trading success.

Norman Hallett
The Disciplined Trader Institute
October, 2010

Question 1: Trading on Fed days.

Question 2: Developing a trading plan with a small basket of stocks.

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Question 1:

Do you stay away from trying to trade on Fed days?

Vad's Answer:

Normally Fed days go like this: relatively active morning, flatlining closer to FOMC announcement time, then sharp spikes both ways right after rate announcement, then some direction slowly takes over. Flatline period is caused by many traders not wanting to have any exposure during hyper-volatility. Notice that lately it's not the actual rate set by FOMC that is influencing the reaction (it's pretty much assumed that the rate will stay the same for a considerable while), but wording about future intentions, so it takes a bit

more time for the market to sort out. My personal preference is to take a few opening trades, then go into self-induced coma till 2:15... then wait out first craziness and start watching for couple closing plays.

Also, if you want free advice (worth every penny, too): do not try to trade first seconds after FOMC announcements. Those wild movements are unreadable and uncontrollable. You don't have to be in every battle. Pick the one you can manage.

Question 2:

I am a new trader, currently transitioning from paper into my business account. My current trading plan includes trading six higher volatility stocks rather than scanning for volume breakouts... to trade other random stocks. What are your thoughts on developing a trading plan using specific stocks to learn their particular dynamics for intraday plays and longer holds? Is it too narrow for success or does it make sense as I transition? Do you recommend newbies trade the higher volatility stocks?

Vad's Answer:

Trading a limited basket of stocks and getting to know their behavioral patterns is viable approach - under one condition. never forget that ALL of them at some point change those patterns. And this is where major danger with this approach lies - a trader gets comfortable with his stocks, almost feels like there is some level of "trust" established with them, they become his/her pets... Of course it's never the case, but this is how it feels. What happens next is, when something changes (and it will), the trader has a hard time letting go, and tries to trade them as before, not admitting that it no longer works. Think of how drastically changed trading patterns of financial stocks after 2007-2008. Think of all those who were buying every new low on FNM, FRE, LEH, BSX. I can cite a lot more examples but you get the idea. As long as you stay sensitive to such changes and can spot a moment when things really change, that is valid trading strategy. As for volatility, well... more volatile stocks are more dangerous, so position size must be kept down. Discipline must be absolutely steel-reinforced on them as they can move very far from your acceptable loss level. And they do carry more emotional pressure... can you handle all this? Go right ahead but BE CAREFUL!

Question 3:

I have read books in which it is recommended that your trading plan should be no more than a page or two - almost just a series of dot points. Yet as I read more on the forum this week I getting a vision in my mind that a complete trading plan may be a sizable document - 10-20 pages. Could you provide some comment on this and perhaps some advice on how to draw the line between making a plan that is a usable ready reference and something that is perhaps too comprehensive or complex that it ends up being a chore to use?

Vad's Answer:

Between comprehensive and cut short I will always go for comprehensive. It's easy to review and modify a relevant part only when you need to troubleshoot your trading; what do you do however if you never included that part in a first place? Well structured plan will be clearly broken down by parts so you can always work with one you need at the moment. See, I am a practical man. When I do something, I want it to serve certain purpose, I don't just go through the formal motions just to check the box. Thus, the question: will a one page document with no details be of any use, or will it simply allow me to put a checkmark to the box next to "create my trading plan"? My answer is: I will write it in details sufficient for it to be useful; I can always shorten it later when I internalize certain aspects to such a degree that they become natural and automatic so I can just mention them in passing. At the same time I must do it with clear and logical structure, so I don't have to wade through 5 pages to find the relevant paragraph. Will it be 5 pages or 20? Well, it depends. For someone who is only starting, I'd expect a plan to start out fairly long, and possibly even grow for a while, as he encounters new areas that he wasn't aware of yesterday. A few years down the road though, it's not unusual for his plan to start shrinking - more and more aspects become second nature, understood by default and mundane tasks, so there is no need to list them. Kind of experienced cook case who can go ahead with instruction "sautee the mushrooms" and doesn't need the whole enchilada of " heat the pan to X degrees, pour the Y ounces of oil"... But he did need it when he was just starting out, right? Just be practical and pragmatic about this - do what serves the purpose. Oh and one more thing - as you modify your plan down the road as you grow as a trader - do not overwrite old versions, save new ones under new name or version number. Leave yourself possibility to go back if needed - and if nothing else, those older versions will provide some nostalgic value in a few years :)

Question 4:

What are the questions I should ask myself to determine the type of trader I am before I delve into the specifics of the trading plan?

Vad's Answer:

That's a good question to ask - building solid foundation for the specifics guarantees that specifics will be structured correctly. Here are some of the most important questions:

What is the moving force behind price changes? Is it intrinsic or perceived value? The answer to this will help you determine whether you are fundamental trader or technical; it will dictate your method of reading the market, choice of a time frame and method of risk control.

Is there certainty in the markets? What is the loss? Is it avoidable? The answer to this will dictate your resolve to use stop losses in a disciplined fashion.

How do I approach the risk? What is it that constitutes the difference between gambling

and trading? Realization that structured trading with strictly defined parameters and disciplined risk control is what makes difference between trading and gambling turns you into professional trader. Expanding on this general idea will lead you to forming your system of setups with all their elements: triggers, stops, profit taking parameters, position sizing etc.

What am I going to trade in terms of market movement? Is it trend continuations? Trend reversals? Ranges? That will start you out on the path of forming your strategies - will you be looking for breakouts or bounces or retreats? Accordingly, that will help you pick your setups.

How aggressive am I going to be? This is going to govern fine details of your entries. If for instance trading a breakout, will you buy the break itself or, in a more aggressive fashion, will enter in advance, before break occurs? Or you want to be a very conservative trader, waiting for a break, then retreat testing new support, so you enter only after seeing that this support holds? Each of these approaches has its advantages and shortcomings.

This is short list but fairly exhausting as far as design of your trading system is concerned. Again, great question!

Question 5:

How many different ideas and trading methods did you study before you focused down and found the right methodology? I find myself jumping all over the place as to what I want to do. Did you go down different roads before you found your focused methodology?

Vad's Answer:

Of course. We all did. No one just "vene vidi vici"... I wandered from one tech indicator to another, tried their combinations, this, that... until understanding of underlying forces and how to read their footprints slowly shaped up. Try to think of that first - smart money vs. crowd, how they act, how their actions look differently on charts... then your approach will start coming together. This is exactly what I wrote Techniques of Tape Reading about.

Question 6:

Do most of the signals and strategies you are writing about apply to both the stock and forex market? Are there any major differences that we should consider when reading these posts in how to develop a trading plan for one versus the other?

Vad's Answer:

Sorry, no Forex expertise here. What I do know and write about applies to equities. While

major trading principles are the same for any freely traded vehicle, there are a lot of details pertinent to each of them. I don't want to do a disservice by carelessly advising about things with which I have no first hand knowledge.

Question 7:

Building an entire trading plan from scratch seems like "re-inventing the wheel". There must be excellent trading plans available for day, swing, and position trading. I would like to obtain several written trading plans for the various time frame objectives and then begin to modify and assimilate them to make my trading plan unique. Any suggestions?

Vad's Answer:

That makes perfect sense and in fact is the way to go. That's why I've written Master Profit Plan - it provides the template, explains how to make your choices and adjust the generic plan to your personal situation, and cites examples helping to flesh it all out. If you simply get a plan written by someone for themselves and want to tweak it, I'd advise to get a few - this way you have more freedom of choices, can get the best parts from different plans and get it as perfect as possible. In any case, do not view your plan as something set in stone - as you start implementing it, you may see that it's lacking in certain parts or delves into something irrelevant for you. Don't hesitate to change it - some do, and feel like they must fit into someone's clothes, never really getting comfortable.

Question 8:

Lots of talk about how important or valuable tape reading is and how few people are skilled at it. I have been practicing in gold and ym market when watching the markets. Taken a few trades, with mixed results. I don't have anything in my trading plan, so I realize that I should either not take the trades or add something to my plan, but have not seen any examples to build from. Any samples or advice?

Vad's Answer:

Before incorporating any new approach or element in your plan, this approach must be learned, right? It is true with tape reading especially, since this term and method are widely misunderstood. Quite a few people think tape reading is just looking at prints crossing the ticker and reacting on them. It's utterly wrong, there is much more to this method than that. Let's start with these two articles:

<http://blog.realitytrader.com/2007/11/whats-in-name-or-what-is-tape-reading.html>

<http://www.realitytrader.com/tapereading.html#philosophy>

Techniques of Tape Reading is your next step if you want to learn more about this approach. Click on icon of this book on the left column of my website to get to Amazon page for the book.

Question 9:

I am a discretionary trader who migrated from being a fundamentalist to a trader. I now put on trades defined by my fundamental analysis and then try to manage the trade using technical analysis. I am sure many of my fellow members on this board must be in the same boat.

Problem No.1: When the trade goes against me, my thinking part of the brain refuses to accept anything going against fundamentals. For example, for the last three days the US markets are moving up against slew of bad news. One cannot accept this easily but it shows up as hugely negative on our balance sheet. That same thinking part of the brain refuses to allow the trading part of the brain to put stop losses and get out. What to do?

Problem No. 2: On those times when we do put in the stops, sometimes the market gaps through. These times you just gape at it and say to yourself, 'hey that is not fair!' and you wish for the market to come up to the SL point so that you can at least get out at your predetermined SL. And it seldom does. I guess it is another ego issue?

Vad's Answer:

Well, the phenomenon of the market moving against the common sense is well-known and extensively described. Actually this is what makes the market work. See, the market can NOT move in the obvious direction dictated by fundamentals. Anyone thinking that "common sense" can be obvious in real time will have to answer this question: if something is so obvious, why would price even move at all? Let me illustrate: stock is at \$20; as a result of some event its price should become \$100 and it's a common sense and obvious for everyone. Who is going to sell it for 21? or 30? or 80? Wouldn't all the sellers simply move their offers to \$101 while bidders wouldn't go higher than \$99? With the exception of one or two slow ones, no one would make any trades at any price but fixed at the common sense level. Market would have turned into total stall with occasional "teleportations" to a new price when a material event occurs. No volume, no trading, no secondary market for companies and industries. End of the whole concept of public investment in cash-striving companies. Any trade requires two components: agreement on price and disagreement on direction. For disagreement on direction to be possible, there must be difference in opinions. Obvious common sense as a market moving force eliminates such differences thus eliminating the market itself. Let me offer you couple links going deeper into this, so you start forming whole philosophy based on these concepts.

<http://blog.realitytrader.com/2008/03/history-teaches-us.html>

Pertinent quote: "1. Logic of underlying events vs. logic of market movement. This is one of the most confusing aspects of the market for many investors and inexperienced traders. We are conditioned to see causes and outcomes as being linked in a logical fashion. Bad news should send the price down. Good news should cause rallies. We want to buy good news and short bad news. We want to trust our analysis and act on our conclusions - and we, naturally, expect the market to follow. So, shouldn't we feel perplexed seeing how the market stages stunning rally when there is nothing but doom and gloom in all the sources

of information?" Read the rest of the article please.

<http://blog.realitytrader.com/2008/04/traders-job.html>

<http://blog.realitytrader.com/2008/03/can-you-afford-to-be-wrong-for-too-long.html>

The topic of taking your loss in a disciplined manner is pretty much related to the philosophy described in above links. Just take them. Nothing will ruin your trading account as surely as refusal to cut your losses while they are small. As Taoist would have said, "Deal with the difficult while yet it is easy; Deal with the big while yet it is small. The difficult (problems) of the world Must be dealt with while they are yet easy; The great (problems) of the world Must be dealt with while they are yet small." (Tao Te Ching, Chapter 63)

Question 10:

I have a two fold problem. First, I write a very simple, easy to follow trading plan. As I simulate its implementation, I continually modify and tweak the plan to get trades that I wouldn't have gotten with the simplest version. Then I add complexity to avoid losing trades. Over time this causes the plan to become very complex, but under simulation, my results are excellent. Then, my second problem is after months of refinement in simulation I go to trade live and I have in the back of mind the losing trades that I have made all these refinements to avoid. I lose focus and I am no longer able to follow the complex plan through the added stress of real money on the line now. This causes me to not follow my rules and I get in an incorrect trade where I take a loss. Then I go back and basically start from square one rewriting my trading plan as a simple easy to follow version that only once again becomes more complex as I practice it on simulator. I know that if I allowed the probabilities to play themselves out I would be profitable at the end of the month if I followed my rules. Why is the fear of going live and risking real money causing me to enter incorrect trades, not follow my rules and how do I get myself out of this vicious cycle?

Vad's Answer:

Books are written on this topic. But I am not here to tell you that and leave you grasping for a real answer, am I? Let's try to find practical solution that at the very least start you out on the right path. What happens when you move from simulation to real money is: fear of losing is added in the mix. Instead of cold-blooded paper trading you deal with emotions now. The recipe of dealing with them is two-pronged. First, you need a solid "philosophical" foundation, understanding what loss is. As you think of market as an inherently uncertain environment based on odds, you realize that loss is unalienable part of trading - there is no way to design an approach that leads to lossless trading.. unless you are a god, that is - only gods are above odds, right? Direct conclusion is, stop tweaking your system to get rid of all losses and accept that some of trades, even ideally structured and executed, WILL end in red. Such acceptance, when permeates your inner core, creates a calmer less emotional approach to actual trading. Second, you need some practical ways to detach yourself from emotions. I want to offer you two. You can modify them and expand on them as you apply them in practice. One is very simple. Diminish the

influence of having real money on the line of fire by eliminating profit/loss column from your screen, so you could observe pure trading signals and not those sent to you by monetary information - it is market movements that must govern your action, right? And, of course make sure that you start small - if your system assumes 1000 shares as your normal trading lot, start with 100. This will help lessen the emotional tension and create right mindset. As you navigate the waters with small position size successfully, memorize the state of mind you are in, internalize it, let it become natural and effortless for you - and only then move to the next step if size increase. The main purpose here is not so much testing the system (that was mostly done on paper trading stage), as training yourself to keep calm balanced mindset. Another is a bit more involved. It calls A Model Trader. I describe it in great details with practical examples in the Master Profit Plan. The idea here (be ready for some seemingly crazy stuff) is:- create an imaginary trader in your mind;- assign to him character traits you think a great trader possesses and want to see in yourself;- let him trade while you stay a detached observer. The point here is to put some distance between yourself and trading process. It allows you to keep your emotions and ego influence away from decision - making and execution; it's a trader endowed with all the right mental attitudes who pushes the buttons. It's not always easy to keep this distance between you and actual trading, takes some practice to hold this imaginary guy (gal?) in your mind, remember what s/he is, how s/he acts and let him/her do all the work... but it becomes kind of second nature in a while and then interesting process of molding so to speak happens - his imaginary traits start becoming yours, you become the one. Takes time, not always easy - but do it and try to enjoy it, it's fun, take it lightly and with some humor, don't forget to give him some funny personality flaw and mock him when he loses... you will find that many psychological problems kind of fade away, become muted. Good luck, and don't tell anyone you are doing that... they may suspect multiple personality disorder. Even my own imaginary trader thinks I have that! Hope all this starts you out.

Question 11:

How did you come to the type of trading that you do? I understand that risk tolerance brought you down to day trading but there are so many paths to creating a plan. That is where i get confused and I don't want to spend all of my time searching for the holy grail. Also, as far as risk tolerance, when you use 1% as your risk tolerance, is that a 1% loss on the portfolio and then you position size accordingly or is that your stop loss?

Vad's Answer:

Let's start with second one. Maximum loss on any given trade is 1-2% of the trading account size, that's considered kind of industry standard. Yes, from there you proceed to establish position size depending on the stop loss placement dictated by the chart. As in: if your trading account is \$100K, you set your max loss at 1% (\$1,000), and chart says stop must be placed 20 cents away from trigger, your position size is 500 shares. There are other factors influencing size, for instance low liquidity can increase an execution slippage, but that's the gist of it. Now, on what formed my approach to trading... I think

the most influential factor was the Reminiscences of a Stock Operator. Description of trading approach, as sketchy as it is in that book, resonated with me, and I started digging deeper into tape reading. The more I learned about it, the more it looked like the real truth about what moves the market and how to read the footprints of the moving forces. Such learning quickly ran into the wall as last books on tape reading principles were written in the 1930s... so from some point onward I was left to my own devices, and had to develop whole idea how to translate general principles into particular setups and trading methodology. That was also what led me to desire to write a modern book on this trading approach, Techniques of Tape Reading. As of today, it's a fully developed trading approach, starting with general trading philosophy, continuing with tape reading principles, translated into exact setups with triggers and other trade parameters.

Question 12:

If I follow a good trading plan, with discipline, how do I know it is effective? Is there a percent of wins vs losses? Or do you measure effectiveness if a certain amount of money is made compared to losses. I am basically wanting to know how to evaluate my plan (while being disciplined) to know if it is effective. Can you give me some ideas?

Vad's Answer:

I would approach your question from somewhat different angle. A good plan is recognized by how effectively it takes you to your objectives - but objectives themselves must be established beforehand. What I am trying to say is, a plan should be judged by the resulting performance in a sense of how that performance matches the targets you set. Let's try and break it down. You start with your objectives. Determine your purpose - is it supplemental income during some available time? Main source of income? Attempt to get seriously ahead while not needing to make every day's living? That will determine how much you want to make on average on daily or weekly or monthly basis. For instance, someone needing supplementary income may be satisfied with 50-100 bucks a day average. If it's intended to become your living income, you obviously will need more - how much more will depend on personal circumstances obviously. In a third case you will press harder trying to make serious dough while ignoring steady stream of small profits. Each of these situations will dictate different risk tolerance, different time frame, position sizing, holding time etc. So, you set those objectives, and then start building your trading system aiming for that target you set for yourself. This of course will include not only trading system itself but all the surrounding elements of a trading plan. Now you have two sides to your planning – the plan itself, as a means to reach your goals on one side, and goals that serve as measuring stick on another. This approach allows you to pinpoint where the culprit is, in the plan itself or your following it. If you follow the plan to the letter and still don't reach your goals - something's missing in the plan, you need to review it and find the lacking piece.

Question 13:

We very often see price action showing breakout with volumes on one day and no sooner

than we jump aboard, the next day the white candle is completely retraced by a black candle and stock goes back into consolidation. What is the strategy you suggest for a trading plan based on trading breakouts? Should we wait another day for some more follow through? Should we wait for the first retracement of the confirmed breakout?

Vad's Answer:

That pretty much depends on the market environment of the moment. During strong steady uptrend breakouts work like charm - that's when "buy high sell higher" works. During choppy ranging markets most breakouts are nothing but a trap - this is the time for "buy low sell high." You can't come up with a single strategy for any type of the market. A trader has to remain flexible, sensitive to the market changes and capable of changing with it. You don't wear shorts in the winter (well, in most places anyway), or a fur coat in the summer. Your trading plan, just like your wardrobe, must include different approaches for different seasons.

Question 14:

Could you go over how to do back testing? What are you looking for?

Vad's Answer:

Let me jump back in for a sec to address a backtesting matter. First, let's return to our definition of a discretionary trader vs. a system trader. As you remember, a system trader has all his trade parameters strictly determined, while discretionary one has some room for, umm, discretion on top of those parameters. Accordingly, the procedure of a backtesting is going to be different for them. In case of a pure system trader, all you need is software allowing you to simulate your parameters on data from the past. Whether such software is available in one's particular trading vehicle and whether data is easily accessible, I can't answer - although I know Forex folks do this kind of things regularly. I've seen one of them tweaking his system and clicking a single button to obtain immediate results for 4 or 5 years back. Now, the discretionary trader's case is not that straightforward because it's very hard to determine whether you'd like the setup back then or not, whether there were some factors at the moment that would keep you from the trade or not. Major problem here is that you already know the outcome (it's past data so you can see what happened next), and you may involuntarily alter your imaginary actions accordingly. Not much you can do about it but try to reproduce your hypothetical decisions as honestly as you can... although here is one twist that may be helpful although a bit labor-intensive. If you can find a few dozens of past charts where your setups were formed, then WITHOUT ANALYZING THEM do this:- print them out and number them all, putting a number in two spots - left and right corner.- find the moment of the setup resolution on the chart - breakout, breakdown, bounce, whatever it is - in other words, the moment where you need to make your trading decision.- cut the chart in half. Put left parts in one pile, right ones in another.- mix left pile and put it all aside for a few days, give yourself some time to forget those details you visually picked up while working with the charts.- in a few days, a week maybe, start going over them, chart by chart, and write

down your trading decisions: Chart 1: Long at 20 breakout, stop at 19.80, target 20.60... etc.- after you've gone through them all, find matching right halves and see what happened next, how your decisions worked. See if percentage of wins is good. See if you can notice what is different about charts where setup didn't work - maybe there is some distinction which can give you a clue what to tweak... maybe volume configuration wasn't right? Stocks that failed were too thinly traded and volatile? It can even be fun exercise. Other than that, remember to paper trade any approach you come up with, whether system or discretionary, but especially discretionary. Backtesting is useful but nothing replaces real time decision-making process. Hope it helps.

Question 15:

I currently have a number of different trading strategies and while some of them have rules in common, each strategy has different rules for entry signals, stop losses, exit timing, etc. Do you think that each strategy should have its own trading plan? Should there be an "umbrella" trading plan?

Vad's Answer:

Trading plan is much more than trading strategy. A strategy with all the rules of entering and exiting the trade is but one (admittedly central) element of a plan. Think of your trading plan as a business plan that describes what you produce or sell but includes much more than that. It outlines your purposes, trading philosophy, trading system (which can include several strategies of course, and describe which should be deployed under what condition), psychological aspects and ways to deal with mental blocks, trading tools, financial side of the business as in expenses toward the hardware, software, research, monthly fees and educational resources... So yes, your strategies will be included in such "umbrella" plan as you call it - with rules that are common for all of them and with clear self-instructions about when to apply which strategy.

Question 16:

Even though I have rules for where I set my stop, I will often exit a trade before the stop is hit to minimize the loss when I see the market starting to go against me and not moving in the anticipated direction. The problem is that very often I will exit the trade with a loss on this "noise", only to get right back in again in the same direction when I see another entry per my criteria that goes on to hit my intended profit target. It ends up being an unnecessary loss. In other cases, it ends up being a good decision to exit before the stop is hit because the loss ends up being less than if the stop was actually hit. I must admit that it is a combination of minimizing losses and feeling the emotion of the market going against me instead of in my favor. I say to myself "Oh my gosh, it is going against me, I had better get out" instead of staying calm, looking at the big picture and seeing that nothing has really changed and my reasons for entering in the first place still exist. Do you suggest keeping the stop where it should be and if it gets hit it gets hit, or look to assess the situation and determine if an early exit is prudent?

Vad's Answer:

My approach is: the stop should be taken when the original reason for entry is no longer valid. That means that until my stop is hit (I placed it at some meaningful level, like under nearest support for instance, right?), the trade is valid. Everything that happens between my entry and meaningful level is noise and is to be ignored. There is a perfect Taoist principle called Wu Wei - non-interference. In this particular case it means: do not interfere with natural forces, let them work their way, your intrusion will make things worse. That said, there is a way to monitor whether you can optimize your stop placement and possibly tighten them. Pick statistically valid number of your stopped out trades and watch on the charts what stock did before and after you got stopped. See what would happen if you moved stop closer by 5%, 10% etc. Maybe there is a level which, if reached, almost guarantees that price proceeds lower and hits your stop - then by all means tighten it to that level and save on narrower stops while not spoiling your win/lose ratio. Or maybe most stocks that hit your stop dive just a tad under it before turning back - so you place it too tight and need to widen it?

Question 17:

I have been trading without a trading plan. How do I start? It seems overwhelming, but I now know how valuable it will be. Will you give me an outline of steps or even an example.

Vad's Answer:

I can't of course go over everything that took a whole book to describe, but list of major elements -sure thing. Here it is (forgive me for using HE instead of he/she, OK :))1) General description of trader's "philosophy" if you will - his understanding of what market and what it is that he, trader, should do in order to succeed. His trading system will stem from this set of concepts; 2) Definition of what kind of trader he is (or is going to be). Timeframe, kind of market movements in terms of trend and range, this kind of things; 3) Trading system itself and this part will be a derivative from the first two. It will include a description of his trading signals, setups, triggers, stops, profit targets. It will also have variations for different market conditions; 4) Risk control - methods, definitions, parameters; 5) Psychological part - how he is going to gauge whether his mindset is right, how to spot the deviation, how to correct it; 6) Practical "business" part - what software, scanner, educational resources etc, summed up as expenses to give an idea of a bottom line and help set the realistic targets and yardsticks; 7) Method of observing, troubleshooting and optimization of performance. It's not really overwhelming, it's just something you need to do in order to bring a structure in your education and actions. Don't think of it as a chore - rather the core thing you do to plan your action. I mean, when you decide to go on vacation, you don't consider surfing travel brochures a chore, right? It's a part of research to decide where you go, what you do there etc... it's necessary and it's fun. Same here - creating your trading plan is not a mundane boring thing to put behind you, it must become a focus of your attention and start governing your actions.

Question 18:

When figuring my profit / loss ratio, I prefer to use a certain amount of trades vs time based. My question is, if I am using 20 trades to make a ratio should I start over after every 20th trade or should I keep a running ratio. For example, when i get to the 21 trades do I go back for the last 20, 22 go back 20 trades etc. or do I draw a line at 20 and start over on the next 20.

Vad's Answer:

I would do a running stat, to accumulate bigger samples. On a grand scheme of things though it doesn't matter much as long as you constantly monitor it and compare with earlier performance - whether you do a running ratio or compare 20 vs previous 20, you will see that something starts changing in the results, thus letting you know that market has changed and your approach needs some optimization. Just pick the way that makes it easier to see.

Question 19:

I have always struggled with developing a trading system because I am a discretionary trader. I trade stocks with huge daily momentum by gut feel so I don't have a particular setup, entry, or exit target. I buy high and try to sell higher. I would like to have a system that told me when to enter and exit a trade. It would help take the emotions out of the trade but I don't know how to develop one. How do I monitor performance and make sure a system I don't have is being implemented properly and consistently? As I write this I'm realizing that probably one of the reasons I have so much trouble with emotions and psychology in trading is that I don't have a trading system but I just don't know how to go about developing one when I'm a discretionary trader.

Vad's Answer:

I know very well where you are coming from since I am a discretionary trader, too - always have been, still am. My definition of a trading system is far from automated system. Let me delve into somewhat generic musings, then we will try and cater it for your case. There is no contradiction between having a system and being discretionary. Being a mix of science and art, trading leaves enough room for both in different degrees of combination. The way I see and apply it is, I have strictly defined rules that describe what I trade - in terms of trend, particular setups, triggers, stops stock parameters, risk parameters etc. This gives me a certain "universe" of trading signals, and then I discretionary pick a "constellation" of those I take while ignoring others. Type of market we are in at the moment, volatility, general feeling of confidence or uncertainty in the market, patterns appearing and disappearing... Let's try and give some examples to give it more practicality. My scanner spits out two signals of the same setup: one is for BIDU or X and another is for STEM. In today's market I will be interested in BIDU while likely to dismiss STEM. The reason is it's not exactly the type of the market where small stocks make big movements unless they get some serious boost by news. There will be a stage in

the market when cheapies will start moving confidently but we are not there right now. Another example of discretion: on a "normal day", if I get a signal on X I am likely to play about 500 shares (half of my usual lot on it, stock is too volatile for full lot). On a very volatile day, I will decrease position size to 300 shares, to account for bigger moves of "accidental" nature. One more example would be refusal to play breakout setups on a day when market shows very little bounces and for the most part just goes down and down - I will switch to breakdowns and bounces while ignoring breakouts. Yet, I will keep an eye on stocks that manage to stay near day high while market sells down those will be my first candidates to start playing breakouts when market reverses. So, as you see - while my system generates a lot of signals, I take liberty to decide which ones I take and how I execute and manage them. There... confusing enough? Such is a nature of discretion; it adds endless ifs and buts. But it also gives you flexibility, freedom to adjust and readjust, be in tune with market. Now, let's try and look into your particular case. From your description, you are what we in our trading room call "momo trader" - momo being slang for momentum. Cool beans, when momo comes - it's a very powerful engine that can take a stock very very far. BUT (you knew there would be but, right?): do they all move totally erratically so you can't systematize their movement, notice some common patterns? No way - and I know this, I love and play momos when the market is right. There are some patterns to them. For instance, have you noticed that breakouts rarely work on them? That is, they work finally as stock makes new highs but first they stage brutal nerve-wrecking pullback, way below what you can safely hold. Try to skip breakouts and wait for this gut-wrenching retreat, buy when it slows down (hint - it normally occurs around previous breakout, which became new support, most likely just below it). and you will see your percentage of winning trades much higher, stops much narrower, profits much bigger, and as a bonus - mental state much calmer. That was just an example, there are other patterns. Watch them move, be patient and observant, take lessons from each trade, notice which entries worked and which didn't. Print out 1 minute chart, put your entries and exits on it and compare what stock did after them. watch for repeating patterns, like: pulling back after your entry, shaking you out. Find better entries on that chart, see if you can do it consistently with the same parameters - then try to do it real time. This is how you learn how your stocks move and create your system.

Question 20:

OK - I know that this has the potential to be a heated topic; but I have a dilemma and want to pose this topic. Here's the scenario. I've been tracking a security and want to take the trade. I have a HIGH degree of confidence that this trade will jump and jump fast. Instead of entering the trade with my normal \$x,xxx amount, I want to go in, say, 2 X \$x,xxx amount (or twice my normal entry size). Stop is still set to lose no more than 2% of entire account equity. My Rule says only enter \$x,xxx amount per trade; but my instinct says, its time to be more aggressive. - Entry Rule (only enter \$x,xxx / trade) will be broke, if I take twice the position. - Risk Rule (don't lose any more than 2% of entire account equity) will not be violated. Question: Is it OK to break your own Rules?

Vad's Answer:

Intuition plays great role in trading. An experienced trader who has been in the market for many years, went through countless situations and participated in many ups and downs has a huge arsenal of "recognizable developments." That's actually what intuition is - recognizing scenario that played out many times in the past, so our trader can arrive to a conclusion how it's going to play out this time almost instantly and without visible mental process of logical going from A to B to C... Yes, feeling in the groove and being confident about the trade one can push harder - with more aggressive entries or higher size. One thing must be said here though: it is very important to distinguish between intuition and wishful thinking. All too often strong desire for a certain outcome is taken for intuition, and that usually doesn't end well. It comes with experience... remember, true intuition doesn't scream in your ear, it whispers... it takes considerable experience to hear that whisper and recognize it for what it is.