



Trading System

Now you have decided that you are going to trade a particular security and you need to find a way of entering and exiting the market. So, how do you approach it, do you just jump in with a gut feeling or do you use some kind of system to help you make the decision.

We will look at a few ways traders decide on the best way to make a decision.

First there is just guessing which way the market is going to go. Now as surprising as it may seem there are many trader who do just that. They take a look at a chart or some news and then decide if they should buy or sell. If they make money consistently then it is hard to argue that this is the wrong way to trade the market. The problem I see with this type of trading is that it is almost impossible to reproduce results consistently. In other words the trader that trades by instinct can never really pass on his knowledge, as there is no clear rules that he applies to the market on a regular basis. I know a few trader who trade like this but unfortunately I don't know any who have gone the distance and are there year after year.

Traders who apply a method to their trading inevitably have better results. If you use the same criteria to each trade then you at least have a reference point from which to work. If you are losing you can then change specific things in you're decision making process in order to find the right criteria. By using a method in your trading you are moving towards the scientific approach and just as a scientist will carefully research and record each experiment so should the trader trying to perfect the method he is using.

If you apply XYZ as your reason for entering a trade and you can see after a predetermined amount of trades that it is not working then you can change X, Y or Z until you find something that does work. Typically the method trader has researched a particular theory he has by doing back testing (applying the theory to historical charts) and comes up with indicators, tools or some other method of determining the entry and exit criteria. If at the end of his research he find that he can make money he will then apply that method to the market.

As he still has to make the decision to enter or exit a trade there is still the human element to consider. Even though his method tells him he should enter a trade for some psychological reason he decided not to take the trade. There lies the weakness of the method trader. Even though he knows he should enter or exit a trade he doesn't because at that particular moment in time some voice inside him tells him not to do it. The solution is to make it mechanical as much as possible.

Mechanical trading systems. There has probably been more written about mechanical trading systems than any other topic in trading. The premise of mechanical systems is that a particular theory has been back tested over a long period of time and has consistently made money. There is no emotion involved with the decision making process at all. If the system says buy the security then you buy or an order is automatically done for you.

This takes away all the emotional up's and downs and all you have to do is buy the system and supply the money. I have been in heated debates with other traders about the value of mechanical trading systems. Some traders swear by them and others think they are a waste of time.

Which is true only the individual can answer. My own personal experience with systems after having tried a few is that they typically produce unspectacular results and after a time they tend to blow up and lose money.

The other reason I am not particularly fond of systems is that when you experience large draw down (your account goes backwards) you tend to lose faith in the system just before it kicks in.

Conclusion

Trading just as in life there are no correct ways to trade only what suits the individual. Some people will be suited to giving it their best bet whilst others will prefer to use a particular method and yet others will prefer mechanical systems.

It's difficult to argue with a man who is making money. My own personal preference is to use a well thought out method, which is 90% mechanical, but the final decision is left to me. Nothing will beat your own research and hard work. If you can find a successful trader and ask him to mentor you this will save a lot of time on the learning curve. Learn every thing you can from him and then adapt it to suit your own style of trading. On closing, ask yourself this question? If you really did have the goose that laid the golden eggs would you sell it?

Good Trading

Best Regards
Mark McRae

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