13 Critical Rules Every Trader Must Know

#1 The Role of Trading Simulation – Seasoned traders often balk at the idea of using a trading simulator. To them, it would be like Lance Armstrong racing the Tour de France with training wheels on his bike. Novice traders are often so intent on making fast money that they hop off of their simulator and “go live” way before they are ready.

Simulators serve several important purposes. To be a successful trader you must prove two things to yourself: You must be totally convinced that your chosen methodology works and you must also be totally convinced that it works for you. At first, the last part of that statement may sound strange. If a trading method works, of course it’s going to work for you, right? Not necessarily.

What if the method really does work but the drawdowns are brutal? Most traders can’t stand a lot of “heat” or pain. I’ve seen methods that had large five-figure losing periods before turning around.

What if the method works, but only trades once every few days or weeks? You can’t trade effectively in a coma and sitting at a computer all day, day after day, week after week, waiting for an entry. That would bore most traders to tears and they would abandon the system.

What if the method works, but is too complicated for you to follow the rules? Get the idea?

To win consistently over the long haul requires unshakable confidence that your trading system works and that it works for you. You must be “rock solid” convinced of this down to the core of your being or you will end up breaking your rules or abandoning your method altogether the first time it hits a string of losers. All systems must lose at some point and losing trades often happen in clusters. Simulators allow you to build this level of iron-clad confidence that is crucial to lasting success.

During your trading career you will want to try out new ideas and add-on strategies. Simulators give us the means to test new ideas before risking real capital on something that may not work.

One of my exceptionally successful students was asked by the class, “What’s the best advice you could give us in order to be successful?” His answer was profound. He simply stated, “Stay in simulation longer than you think you need to”. Any trader who left simulation only to blow up their live account fully understands the importance of that excellent advice.

#2 Never Snatch Defeat From the Jaws of Victory – There just isn’t any excuse for losing on a trade that was winning but it happens way too often among traders. Our emotions are usually the culprit as we try to milk the trade for just a few more ticks beyond our original goal. When the market turns on you, you focus on exiting as soon as the market returns back to your original goal…but it never does as it just gets worse and worse until we finally exit in frustration and anger at ourselves for our greed and vowing to never do that again…at least not until tomorrow.

If you are in a trade and Price is very near your goal, move your stop to at least break even plus a tick. We call this getting "bulletproof" and it does wonders for keeping us relaxed in a trade when we know we can't lose no matter how the trade turns out.

This depends on your profit target, of course, so don't choke the trade with the stop getting too close to the price level to where market noise takes you out.

#3 Getting Profit Permission – This means that you should never increase your contracts if you aren't making money. If you want to add contracts, the additional account margin should come from your wins, not your wallet. Every trader should know that if you aren't making money with one contract, you can't make money with ten. Let your trading profit give you the permission to add more contracts to your trades. Take it slowly and never trade with a potential loss greater than you can afford. Scared money never wins.

#4 "Dance With the One That Brung Ya"- If you get nothing else out of these Rules, understand that true trading success is not found in any particular trading system. It's how you use that system that matters.

One of the traps that many traders fall into is always searching for something near perfection when what they have is already more than sufficient. They become Webinar and Seminar junkies and they comb the Internet in search of the perfect system that never (or rarely) loses. They search in vain because the only Holy Grail that exists lies in the trader, not the system.

But most traders are perpetually ignorant of this key fact and they jump from system to system from day to day… sometimes intraday. Finally, they run out of time and money and resolve that all trading systems are scams and none of them work. In reality, they didn't stick with one long enough to master.

If Tiger Woods changed his golf swing as often as many traders change strategies, he would have been destined for obscurity. If you know your system works and you know it fits your trading style, stay with it until it becomes second nature. Don't give in to the temptation to change methods in a normal drawdown period because you want to try out a new unproven system. That's what your simulator is for.

Your trading system is your partner and your lifeline to long-term success. Never abandon your trading system unless you know absolutely that it no longer works.

#5 Don't Attempt to Mimic Someone Else's Trades – This is one of the hardest things to get across to traders. After all, logic dictates that if a trader is successful, all you have to do is do what they do, right? Wrong. That trader has probably spent years developing his or her unique style wrapped around some common rules. They have probably developed a keen sense of the market which cannot be conveyed quickly to other traders. All skills are like this and make no mistake, trading is a skill.

Experienced successful traders have mastered entry and exit timing. They make split second decisions sometimes on both plus the stop placement. If you are an observer trying to copycat the online trades at home, you will always be lagging. Your entries won't match, nor will your exits. You will nearly always get slippage and slippage is a major enemy in trading.

Consider also that your trading guru you are trying to mimic may have a much higher tolerance for drawdown pain than you do. Or, maybe your smaller margin account can't keep up in a string of losses or if your mimic mentor decides to scale in to the trade.

The rule here is: Find a good trader that is also an excellent mentor and educator and learn from them until you finally know everything they know about trading that fits your personality and preferred trading style.

 # 6 The Market Rewards Patience and Discipline – One of the first rules the market teaches is that it plays no favorites. It treats everyone the same…big players and little guys alike. The market is not out to harm or help any individual. It's just going where it wants to go because it can…and the market is always right.

Think of a deer hunter who is cold and wet and hungry. He knows the deer are out there because he has seen all the signs. But he knows that if he gives into temptation and goes charging into the woods after his prey, he will surely remain hungry.

The deer is like the market. It is ignorant of the hunter (trader). It goes where it pleases when it pleases. The hunter is like the trader. He knows the deer (market) has the ability to go wherever it wants but he has studied the signs (signals) and enjoys a good probability the deer (market) will come to him. But the hunter must have the patience to let his objective come to him and then have the discipline to follow his "rules" of waiting for a clear, clean and close enough shot to stand the best probability of achieving the desired outcome. So it goes for the trader. But, make no mistake, waiting is not the same as hesitating. Hesitation is a sure sign of a lack of discipline which causes loss due to breaking a rule due to emotions.

As a trader you must work to achieve the level of patience required to succeed in your craft and also have the discipline to follow your rules at all times.

Discipline is often misunderstood by the trader. Many follow rules until they feel they need to bend one. So, they call it a "guideline" and break a rule. No big deal, right? Wrong! If you break a rule, you forfeit the right to call yourself a disciplined trader. So, make the commitment right now. Take a solemn vow to never ever break a trading rule. Break your rules and the market will break your trading account every time without exception.

#7 Capital Preservation is Paramount – Most traders know that you can't trade without a brokerage account and that requires some level of capital. Many traders also fail to realize how important capital preservation is. It is everything in trading.

Without your trading capital, you can't trade and you must re-fund your account to trade again. The problem is, you haven't solved the problem of why you blew up your original account in the first place. The odds are you will continue to lose until you can no longer trade again. How can we stop the hemorrhage in our trading account and start to build it again?

You should have the following rules in place to prevent this from happening: Set a daily loss limit and a per trade loss limit. Many trading pros will not risk more than 3% of their trading capital in any single trade. That means, if you have an account of say $5,000 and you are trading one contract with a stop of 3 points, then you are not breaking your 3% rule. Likewise, if your trade only required a 1.5 point stop, you could put two contracts on the trade.

For a daily loss limit, some traders use 15% to 20% of their capital but this would depend on the trader. If you were down 20% for the day, that would be $1000 and many traders would be near panic. A panicked trader is incapable of trading effectively and if more trading ensues, more loss will result. Large loss begets greater loss.

Set a daily loss that you can emotionally handle. That figure will vary from trader to trader. But a cardinal rule should be that all traders should stop trading immediately if they feel any anxiety whatsoever about the day's losses. If losses continue and you find that your trading account is down 25% to 30% over time, STOP TRADING and get back on your simulator until the loss problem is identified and rectified.

#8 Trade Management is Everything – Consider this fact: Traders can win with a strategy that only succeeds 40% of the time. Conversely, some traders could lose on a system that won 100% of the time. It all has to do with Trade Management. This also encompasses Risk Control but I believe both fall under the same Trade Management umbrella.

In all trading markets, small loss is inevitable but there is never an excuse for a big loss. The majority of traders consistently lose and the majority of traders suffer large losses. There's definitely a connection.

Learn to have fun with your losers. What the heck does that mean? Well, you feel good picking a winner, don't you? You should feel the same way for spotting a loser quickly and getting out with only a small loss. But this does not mean you should sit there with your cursor on the Cancel button and panic at the first flash of the wrong color bar either…but that's where training and experience comes in. Learn to identify the moment the market is really telling you that the trade you are in is not going to work rather than waiting for it to hit your stop. Then get out of that trade immediately even if doing so results in a loss. It will be small if you are managing the trade correctly.

Remember: Every individual trade you take is essentially meaningless, win, lose or break even. It's just one of many thousands you will probably take in your career. No single trade defines your success or failure as a trader. As long as you enter and manage your trades correctly while obeying your rules, then you did your job well.

#9 Shoot for Singles, not Home Runs - More baseball games are won on base hits than knocking the ball out of the park. Trend trading can be mastered but I believe it would take years of hard work and incredible discipline. The markets spend most of their time going sideways so trend trading can cause a lot of "false alarms" that never make it to trend status. I'm referring to intraday traders and not position trading which always try's for a trend.

Traders who consistently see great signals and enter correctly but still manage to lose are those who are trying to hit it out of the park rather than taking what the market actually wants to give you.

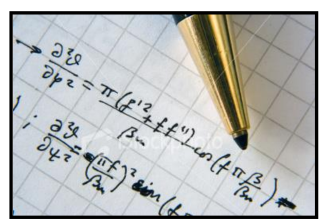
#10 Never Scale Into A Losing Trade– I'm not a big promoter of scaling out of a trade but I know many traders do it successfully. But, most trading professionals agree that you should never scale into a losing trade. The premise is simple and devilishly deceiving. You take a trade. If it wins, great. If it goes against you, you simply add more contracts. If it goes against you, you add even more. Eventually, the market has to turn around, right? Yes, sooner or later it will. It's the "later" that kills you.

They call it the "gamblers mentality" and it's a recipe for disaster. You try it once and it works. So you do it again...and again and again. All goes well until you hit that Killer Trend. The one that refuses to pull back enough to let you exit gracefully with a profit. I met a trader a few years ago that loved to scale into his losers. He actually accumulated a nice string of winners...right up until he lost most of his $100,000 trading account in one trade. Scaling into a loser is Trade Management at its worst.

#11 Get Into the "Swing" of Things – One of my students is an avid golfer. One day we were talking and he said he compared his trading to his golf swing. He went on to explain that he practiced his golf swing every day until it became automatic and his golf game improved tremendously. He applied the same principle to trading. Once he perfected his methodology, he simply practiced it in simulation until it became second nature. This resulted in great timing and execution without hesitation plus flawless trade management for him.

The rule here is practice, practice and practice some more. In my many years of experience working with literally thousands of traders from all over the world, not a single trader, experienced or novice has ever been able to bypass lots of practice and still succeed. Practice may not make perfect but practice can sure help make profit for practically any trader.

#12 Paralyses by Analysis – The human mind is a funny thing. Put a trader in front of a chart and it immediately sees it as a puzzle to be solved mentally. Pretty soon they figure they got it nailed when, in truth, they don't have anything but a lot of subjective guesswork.



As a whole, I have found engineers and scientists to be the hardest to break the tendency to overanalyze. These brilliant minds have a hard time because, by the time they finish analyzing, they missed the trade. Conversely, some of my quickest learners have been pilots. They're used to placing total trust in their indicators at the risk of their lives. So, they have no problem trusting their market indicators while risking a relatively small amount of capital.

An overanalyzing trader loads up on indicators, combs the internet for news and hesitates until he is convinced the trade is working…then enters where he should be exiting.

#13 Get a Grip – Mastering a relatively simple trading method and execution platform should not take long, so what's the hold up? Why aren't traders making steady incomes after a few weeks of practice?

It is because understanding the mechanics of a trading method are only part of the puzzle…and a small one at that. The much larger challenge is mastering ourselves and our emotions so we don't choke under pressure.

If just finding a good robust trading system was the key, why then do such systems have so many traders who fail?

Many great books have been written about trading psychology and among the best is "Trading in the Zone" by Mark Douglas. If you read it, you will be an improved trader. If you read it again, you will be an even better one.

Summary

Trading can be an incredibly rewarding career. It can also be a frustrating one. It depends entirely on how we perceive it. For those looking for a get-rich-quick scheme with little or no effort, their dreams quickly fade and so does their trading account. But, for those who approach it as a career and a skill they must study and work hard to develop, the results can be amazing. It can even enrich your personal life by making you more patient and relaxed.

Nobody chooses to be a doctor and looks for riches in 30 days. No one studies to be an engineer and in 90 days attempts to build their first skyscraper. But with trading, many people expect instant results. And that's mostly the fault of the industry itself and the way most trading systems are marketed these days. People expect to get rich practically overnight with little effort because that's how most trading systems are marketed. There is only one true Holy Grail and that, my friend, is in you. Your system of choice is just a tool. And like any other tool, mastery is only achieved with commitment, a good dose of effort and lots of practice.

For those who see trading as a career choice and have the passion to make it happen, it can be very rewarding indeed. Never forget: Your rules are your lifeline and must be obeyed all day, every day in every trade you take.

May you enjoy health, wealth and lifelong happiness in everything you do.

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