Trading Is A Business of Losses

Almost all advertising for trading and investing products and services either promises an easy road to wealth or at least implies that great profits will be made quickly and easily. Almost all books, seminars, videos and other trading and investing educational products leave you with the impression that if one were to follow their instruction, our equity curve would be at no less than a 45 degree angle. Any dips would be few and of little consequence. None of these promotional and educational materials even suggests that trade or investment losses may be more frequent than gains.

You Must Deal With Today's Reality To Succeed

Trading is no different than any other business. Success will never be achieved unless the business owner deals firmly with the reality of the business operation today. While it is necessary to envision and plan for the future direction of a business, the envisioned future will only be obtained by actively taking care of present circumstances in a manner that will ensure the vision of the future.

We often lose track of the universal truth that the future is nothing more than the consequence of the present. This is the immutable *Law of Cause and Effect* that is inescapable. We can only take advantage of our understanding of this law by also understanding we are totally responsible for our future condition. Why? We always have the choice how to act, what decisions to make today. Today's decisions result in tomorrow's consequences. So, what does all this have to do with trading?

Trading Is A Business of Losing

Consistently successful traders usually have more losing trades than winning trades! What's that you say? All of those advertisements, books, workshops and videos seem to imply that their trading methods ensure consistent and overwhelming winners. They never told me about all those losing trades. If loses were even mentioned, it seemed they would be so infrequent and small as to be virtually inconsequential.

Why does this illusion that losses are not a major part of trading activity continue to predominate the promotional media? Because that is what we want to buy – the idea that losses are not a part of the business. Reality doesn't sell nearly as well as illusion. If it did, the infomercial business would end tonight and most magazine and direct mail advertising would dry up very quickly.

Hard work and relentless education are tough sells. We believe what we want to believe. The promoters know we are looking for a sure-fire way to easy wealth and financial independence so they simply create the illusion that they know how to achieve this. They are selling us what we want to buy. As long as enough people are willing to buy into the illusion, someone will offer to satisfy the illusion regardless if the product or service can deliver or not. Find a need and fulfill it.

If the majority of successful traders have more losing trades than winning trades, the average winning trade must be greater, much greater, than the average losing trade. Most consistently successful traders have more losing trades than winning trades. If the majority of trades are losers, do you see why it is so critical that the losing trades minimize each loss? Yet the vast majority of inexperienced and unsuccessful traders focus almost entirely on the potential profit of a trade and completely ignore the second side of the equation –the loss potential. It is equally important to plan for what to do when things go wrong as to plan what to do when things go right.

Relentlessly Focus On Minimizing and Managing Potential Losses

Every trade is a potential loser as well as a potential winner. The key word is potential. We never know how it will turn out. The only way to protect ourselves from catastrophic loss, is to plan for a loss on every trade. How can we minimize the loss?

The same trading approach that resulted in the trade-entry decision must also determine the trade exit decision. Let’s say your technical analysis suggested a market is in a position to make a low and reverse trend and you will enter only on the close of a *reversal-day*. If the trade-entry decision to enter a long position is triggered on the close of a *reversal-day*, the trade exit decision can be no further away than one tick below the low of the *reversal-day*. This must be the maximum acceptable loss. The day is either a trend reversal-day or not.

Or, let’s say your market analysis has suggested that a bull trend is underway and the minimum time and price targets for the bull trend are still far from the current market position. You decide to use a *trend-continuation trade-entry* such as buying the break away from an *inside-day*. To go long using the inside-day trade-entry strategy is to buy on a stop one tick above the high of the day prior to the *inside-day* and place the protective sell-stop no lower than one tick below the low of the *inside-day*. The same strategy that triggered the trade entry defines the maximum stop-loss strategy.

Each of these two examples illustrates the trade exit decision is a function of the trade entry decision. Identifying the conditions to enter and the conditions to exit the trade are equally important and must be determined in advance of actually entering the trade.

While *Dynamic Trading* is a disciplined and systematic approach to technical analysis and trading strategies, some judgement is required to arrive at what we believe is the market position at any one time. Don’t all successful businesses require judgement by the owner? At the same time, all of the trade-entry strategies and initial stop-loss strategies are completely objective. There are two categories of entry strategies – trend-reversal and trend-continuation. Each has completely objective entry triggers and initial stop-loss placement.

Once we have decided that the market is in a position to make a trend reversal, the entry and initial stop placement becomes a no-brainer. The market itself must confirm the potential for a reversal by making one of the four *trend-reversal entry signals*. Once we have decided that a trend reversal is confirmed, we simply implement one of the *trend-continuation entry signals* each of which has a completely objective entry-trigger and initial stop-loss target.

These have been just a couple of examples of how the trading decision must include both the trade entry strategy and the initial stop-loss strategy.

What Is The Market Condition That Will Void The Decision To Be In The Trade?

The initial stop-loss placement is the key to minimizing losses. Many inexperienced traders will enter a market and refuse to exit quickly if the market moves against the position. They are more focused on their trading decision being right and the big potential profits from any one trade than on protecting capital. They often lose site of the fact that without capital, a trade opportunity cannot be taken advantage of.

The key question a trader must always answer is “What is the market condition that will void the trade decision?” This question must be answered before the trade is initiated and while a successfull trade is in progress.

This discussion has not meant to be a comprehensive tutorial on trading strategies including specific stop-loss placement. The objective is to get the trader to think as much about potential losses as about potential profits. They are the two sides to the coin of successful traders. If either side is ignored, success will not be attainable.

The *Dynamic Trading* book and the *Dynamic Trader Trading Course* that is included with the Dynamic Trader Software package provides comprehensive instruction on trading strategies and trade management with the objective of maximizing net profits by minimizing individual losses.