EP78: Stacking The Average Joe

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Darren: To make the market not stacked against you, you do have to think outside the box...

Announcer: Two Traders, Darren and Walter, pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the Two Traders Podcast.

Walter: Good day, Darren. Welcome to the podcast! How are you today?

Darren: It is a good day.

Walter: Awesome! It's great to be on holiday, isn't it?

Darren: Awesome.

Walter: So, we were talking about this idea before we start recording, this is the idea that there is a lot of rumbling around. I guess this happens a lot with forex traders in particular, at least that's my belief.

You hear a lot of forex traders talking about how the whole thing has stacked against them. "My broker has screwed me over" or whatever. You will hear things like the institutions have all these quants and these algorithms. They are in and outs of the market really quickly, they are executing faster than you can and all these stuff.

The idea is that the markets are stacked against the average Joe trader, for one reason or the other. It could be the broker, it could be the fact that the big institutions get to push the price up and down, they are the ones that moved the EUR and this and that.

My thoughts are... I've got lots of thoughts on this but I am curious to hear what your thoughts are on this idea of whether or not the markets are, basically, the odds are tilted in the favor of others rather than the average trader.

Darren: I am not sure I would agree that tilted in anyone's particular favor but I do think that the markets are stacked against the average Joe trader and not in sort of conspiracy sort of way that we're being cheated or anything.

I just think that there's a lot of people trading and there's a lot of money to be made so we are playing a game that is highly, highly skilled. Essentially, if everybody is highly skilled, then you really need to be highly skilled yourself and then luck will also play a part in it.

The idea that you can just come up with a simple systematic trading system and make a nice, consistent games over the long period is a little bit unrealistic because there is so much gain to be had out there.

So much skill, knowledge, education and the best minds, that is what you are up against. There is no getting away from that fact and if you look at performance of hedge funds, they've got the best technology, the best information, the best minds.

Many of them do not post returns way above the average and many of them have losing years. The idea that you can just wake up, learn a little about price action, read one or two books, perhaps do a little bit of reading about psychology, and then you are going to make your living from trading is a little bit unrealistic.

As harsh as it sounds, it is stacked against you and you are really going to have to work hard, you are going to have to come up with some imaginative thinking, you are going to have to train your mind and learn about how you deal with emotions.

You are going to have to keep good records. It is really competitive and hard. For that reason, I would say, definitely stacked against us. I know that is not really the angle you are going on but that is how I perceive it.

Walter: I think right when we enter into the market, the odds are stacked against us. The numbers sort of bare that out but I think it is kind of what you are saying. To me, the reason why this is the case is not necessarily because your broker is going to cheat you.

Not necessarily because these private funds have quants and algos and robots that they are in and out of the market or if you are letting it in or whatever. Hedge fund managers are just as prone to these as anyone else as the individual trader who is trading in his underwear in his living room.

We all have to deal all these psychological issues and, for lack of a better term, cognitive biases or errors in our thinking. All of these things come up and everyone in the market has to deal with these.

The big competition for each individual trader, the big issue, is yourself and your own issues that you have. To me, that's a tricky part and from what I've seen from traders -- the very successful traders, the most successful traders --they understand this and this becomes their focus.

In the end, it is no longer about the best exit, the best entry. It really comes down to how do I get to a point where I can accept the decisions that I am making and how do I know if I am making the right decisions.

I'll give you an example. Let's say you are in a trade and you've sold the EUR and you decide that you are going to take this EUR trade until it makes you 120 pips but the EUR trade goes 70 pips and starts to retrace sharply against you.

You say "You know what? I am going to stop out at breakeven here. I do not want to handle it. I cannot handle that." So, you dumped it and you bag 60 pips. The issue here is that your goal and what you really wanted to do was make a 120 pips you only made 50% of that.

You made 60 pips instead. The next thing you know, four-hours later, it goes 200 pips in the expected direction and you would've hit your 120 pip target. The question is what do you do with that information?

Did you make the right decision when it was retracing sharply against you? How do you deal with that? And even more importantly, what does that mean for the next trade? How is that going to affect your thinking going into the next trade?

To me, that is the meat of what we have to do with these traders, it's that right there. That's it. To me, that is really what it all boils down to.

Darren: I see a lot of traders where they used the discretionary element of their strategy to paper over the cracks. There are big holes in their strategy that they have not thought out.

Going back to the example that you gave then, I am presuming that trader would have had a rule that "Okay, my target is 120 pips but if x amount, if price has given me the signals, is reversing then I will manage my trade".

That is fine because when you do your backtesting, you would apply those rules and see if it is profitable over the long period. The problem is there is a lot of traders who do not have those rules.

They have "Okay, this is what works for me. I am getting in this trade on the EUR and my target is a 120 pips and there is no management in between" and then they manage it. Essentially, they'll end up trading a different system to the one that they planned to trade. I think that is the problem.

I see it more often on exit than entries where traders get into a profitable trade and then they alter their exit rules and they apply some reasoning why they were allowed to do it this time.

Poor planning is a trader kind of stacked in the odds against himself. It's very hard to do that because when you literally lay all your rules out there with the minimum discretion then you really get an honest appraisal of how well your system works or not, how much of an edge you've got.

A lot of traders are really uncomfortable with realistic edges. They want to believe that they are going to be able to draw a paycheck every month just by doing their work.

Unfortunately, some very special traders with really good edges might be able to achieve that. The majority of traders, they do not have that. I know many good traders with long, long track records that have losing years.

They specialize in one subject, maybe trend trading, so they clearly know their business but they still cannot avoid the fact that sometimes that is going to happen. How we approach trading and how well we planned out, what we are going to do, stacks the odds against us.

Sometimes we are a little bit lazy and we just live on the hope that my system is actually better than it really is.

Walter: Yeah, and what's interesting about the example that you are talking about is that you can do the exact same thing in that instance. You could have a 120 pip, you are looking for a 120 pips, you got out at 60 pips.

Depending on what the rules are, basically, what you were saying is depending on what the rules are of your system. In one instance that will be the right thing to do it and you execute the system perfectly and in another you totally dropped the ball.

It all comes down to what you've planned out. How does your execution map into your system? I think that is really the piece here that the people are missing. Really, what it comes down to, Darren, is just responsibility.

Just taking responsibility because there is a cap out, isn't it? It is a cap out when you say "My trading would've been better, I would have made money last month if my broker did not keep slipping me".

Or, "I would've made money if that news had not come out the way that it did" or whatever. It is like people do not want to admit that they are the ones that are pulling the levers in their account.

They are the ones that are setting their lot sizes putting their profit targets, getting out of the trades, getting in the trades. You are the ones that are responsible for everything that happens to your account.

Just taking that responsibilities are a big step towards becoming a successful trader and a profitable trader because if you are not, if you are always blaming the boogey man in whatever form, I do not really see how it is going to work for you.

I just do not see how it is going to work. It is just accepting responsibility, becoming self-aware and you can do that too. I know you are a big fan of writing things down during a win and keeping really good records but, in some way, it is about self-discovery.

It is about taking responsibility, discovering about yourself and then coming up with a plan because you are the one that is, really in a way, each individual trader is the one who is holding. We are holding ourselves back.

That is what it comes down to so it is not that the private funds have an advantage. It is not that the bank has an advantage. If you think about it like the leverage that the average forex trader has is much greater than any private fund has.

I can guarantee to you that the private funds do not have 500 to 1 leverage or 200 to 1 leverage or whatever. They are not in and out. It is tricky for them to move at their positions getting in and out.

They are not as nimble as retail traders are so the fact that you are trading from your underwear with high leverage in your living room or whatever, there a lot of advantages that people do not think of.

They do not really consider those. To me, it is stacked against the average trader but not for the normal reasons I suppose that people blame it on.

Darren: Why do you think that retail brokers get so much bad press? I know there's certainly must be bad brokers out there. I wonder whether really the majority of it is that traders are sort of starting accounts being under funded and those small elements make a big difference then.

I did recently try and just sort of check out what new brokers were available in the UK. For various reasons, I like to use "Spread Bet Broker" and I like "Fixed Spread Brokers" because it suits the way I trade.

I pay a little more on my spreads for that but I've never been the person where a slightly lower spread is going to make a big difference to whether profitable or not. You could argue the fact over a long run that I would've made more money. There is more to it than that for me, personally.

Why do you think that it's this such a mass of bad press about brokers? Is it because there is a lot of bad brokers or is it something else going on?

Walter: I honestly think that, certainly, there are brokers that are shady. There are brokers that make it difficult for you to withdraw and slip you and give you bad ticks that pop you out of positions and all of those sorts of things.

The biggest problem, I believe, is the trader himself. I think that trader is not wanting to take responsibility for the fact that they over leveraged and put too much in that account. I think the stats bare that out.

We know that retail forex brokers, the lifeblood, the reason why they exist is because they keep pulling in new accounts. If they do not do that, they'll die. The reason why that is the case is because the account's burned out.

They have a short shelf life. They just burn them out. These traders come in, they ramp up the trade, they took huge risk and they blow up the account. That is why Oanda, which offers a 50 to 1 leverage as a max leverage, that is why those accounts last longer than any other broker because they offer the lowest leverage.

To me, it is correlational data. It is not that you do not know that it is correlational but I do believe that traders, in essence, cannot get away from their own selves. They take too much risk and they do not want to take responsibility for the fact that they took too much risk on.

That is what I believe. It just seems that it is too much of a coincidence that the broker that offers the lowest leverage is the broker that has the longest lifespan customer. Traders, they last longer. It just makes sense.

It is easier for us to blame it on someone else and say "You know what, you are right. I should have opened up a $3,000 account and take 2 standard lots" or whatever. It's just crazy.

Darren: What about the notion that algos and funds look for where all the orders are placed and take out all of our stops before reversing price in the original direction? It is sweeping for liquidity. Do you believe that?

I believe that that goes on because when you get to larger size then, obviously, you need to find liquidity to place your larger orders. This idea of hunting stops, is this something that is true to you or not?

Walter: Yeah, I think so. That's always been going on. You can go back and see that on the charts in the '70's or whatever. I think you'll see that they were essentially what you are saying. The reasons why you get all these spikes and as I see as a support and resistance trader. Largely support and resistance trader, as I see it, these spikes that spikes in support and resistance then rebound off of that, those are signs of that basically.

They are trying to probe the market into those areas where they know there's a lot of orders sitting there so that they can basically pull them off the board. I believe that.

Darren: This is why when tested, a much wider stop, initially, performs much better. Again it is one of those things that it is stacked against you as retail trader because your gut instinct is to pull your stop in tight. Have a smaller risk as possible to try and get that big risk/reward but the statistics proved that you want to use a wider stop initially.

Then if price moves in your direction then start to pull it up. Again, it is something that you very rarely see retail traders do. They tend to start with as tight a stop as they can until a support and resistance and then move it to break even almost as in maybe one to one too quickly essentially.

Whereas, really what we should be doing is starting with a much wider stop and then bring it in closer to the trade but not straight up to break even. Moving it to break even not as abruptly.

Once it's moved so far a good distance then move to break even. Again, it's your gut instinct leading you astray and if you study the charts long enough then you'll realize that, it is not the best thing to do.

It is very hard to change that habit. I'd very rarely see traders talking about changing their stop placement. Their gut instinct again, would make them look at the entry or the elements that are a least likely to have a good effect on their profit.

Walter: Absolutely. It is interesting that you bring that up. I recently read a study that they did but it wasn't stocks so it was not in currencies. There are slight difference to the way that, I believe, that the way stocks traders approach it. Currency traders, I guess, are closer probably to the future traders in the way they approach things.

What was interesting about the study was that he looked at the baseline. He was looking at the stops and so the baseline was that he was going to have essentially a timed exit. After a certain amount of time, they'll just pull the plug on these trades and the trade was done.

The baseline was no stop so there was unlimited risk, essentially, and that ended up being one of the best strategy. When you look at things like ATR-based stop, stops based on volatility, you say for example that the EUR moves an average of 85 pips a day so you use a two ATR stops so you have 170 pip stop.

Stop like that were awful, were absolutely awful, compared to the no stop scenario. I just thought that was interesting because some of those things -- and I know you talk about this a lot -- I like to think what are other people doing and how is it that I can do things a little differently.

I know you do a lot of that in terms of questioning the norm which I think is a really healthy thing to do just in life, in general. I found that fascinating that the volatility-based stop and the volatility-based exit strategies didn't work nearly as well as just a timed stop and timed exit and no stop. It was fascinating.

Darren: To make the market not stacked against you, you do have to think outside of the box and it is probably a good exercise to design a basic support and resistance trend pullbacks system.

Basic, off the shelf one, and then just go for all the elements. Just question the rationale behind them because, generally, a lot of us are trading in the same way. We are all pretty much doing the same as everyone else.

If the majority aren't winning, then you need to question the thought process that makes you think that that is the right way to get an edge in the market.

Walter: Absolutely! That is the key. We have to remember where we are getting our profits from. Really, in the end, we are getting our profits from the other retail traders. Essentially, they are donating their profit. They are donating their account and we get to collect those profits if we make a profit on any given trades.

What are you doing that is different to what they are doing? How are you able to be on the other side of their trade, in essence. It makes a whole lot of sense. That is why, to me, some of the most interesting traders, you'll hear them talk a lot about this like, "Why is it always been done that way?"

These things come up, they question the norm and wonder why is it that people always do these and why can't you do these instead and these sorts of things. I think it is a healthy way because it can lead you to a dead end but it can also lead you to a fruitful place where you can collect different… It can be something that is burst to a different direction.

To me, that is good. You do not want to be the same guy that has stop where everyone else has their stop, right? You do not want to be that easy, low hanging fruit for the big boys to spike through and clear out your stop. That is not what you want so I think it makes a lot of sense to do that.

Alright! I guess, Darren, we've basically decided that the markets are stacked against the average trader but it is really the average trader's fault, right?

Darren: Right. If you cannot find an edge and you can learn how to not control your emotions, learn how to read, analyze your emotions and you keep good records, then it is still possible to make consistent gains trading.

Walter: Absolutely. It is all about your own approach and being aware of how you are doing things that is right. Well, thanks for your time, Darren. We'll see you next time.

Darren: Cheers, Walter!