Aspen TRADING GROUP

TOP 10 REASONS

WHY TRADERS FAIL

by DAVE FLOYD

By Dave Floyd, Founder and Head of Research and Trading at Aspen Trading

I caught the trading bug over twenty years ago while talking to a co-worker at Scudder Stevens & Clark, the Boston-based investment firm where I worked at the time. My coworker said, "You know, Dave, if you're interested in training, you should read the Market Wizards books." I had never heard of them, so I grabbed both books at the Coop, Harvard Square's famous bookstore, on my way home. Two days later, I had read both books, and was hooked.

In the two decades since, my quest to conquer trading has been incredibly successful. Just a year after reading the Market Wizards books, I was hired by Standard Chartered Bank and flown out to San Francisco to work at their FX and fixed income desk. I was in heaven. There were wall-to-wall quote screens, and because much of trading back then was done via "the hoot" on the trading turret, the atmosphere was electric. Excited verbal buying and selling went on all day.

I was exactly where I wanted to be, but a year later, Standard Chartered consolidated offices and asked me to relocate. I had grander ideas. I had spent that year learning everything I could learn in an office setting, and had brainstormed ways to profit from intraday price action. The sales rep for Track Data (a quote vendor) at the bank let me in on a little secret: there was a group of guys who had just moved off the floor of the Pacific Stock Exchange to trade NYSE stocks electronically. Back in the early '90s, this was a radical idea… and I loved it.

So at the seasoned age of twenty-four, I left my cush job at the bank and decided to leverage a small severance package and modest savings into my future fortune. I opened an account with the same clearing firm as the guys my sales rep had told me about, and was instantly in business as a day trader of NYSE stocks. I said to my future wife, "Guess what, honey? We're going to be rich!"

Then, reality sunk in. I had no idea where to start. Sound familiar?

When real dollars were on the line — my dollars — the blank trading screen in front of me was terrifying. I won't lie; I spent the first several months struggling to make consistent profits as I learned how to trade without any real coaching from a professional. I had a radical trading plan formulating in my mind, but no idea if it would work, and I was shy about trying something so bold. My trading style reflected my fear. If I saw the offer on a stock start to reduce, I'd hesitate before placing the order and end up losing out. I wasn't making any money, and I was paying a $1,000-a-month "desk fee," working part time in a somewhat degrading position as a cold-caller at Merrill Lynch, and constantly hearing success stories from my college buddies, who were getting promotions left and right at their office jobs and making much more money than me.

I was really starting to get discouraged when a new trader showed up in the office. He only had about a year of experience himself, but right away he started banging out trades with utter conviction. I was stunned, not just by how much he was making, but because he was using the exact same trading style I'd been lobbing around in my head, but had been too scared to act on. I hadn't yet had the conviction to execute, but he had, and he was winning.

This moment was a turning point for me.

I began to act on my radical trading ideas, and within days was making more money. In a few months, I was banking some serious coin. By 1997, I started my own day trading firm, FMB Trading. At our peak, we had twenty traders, and our office alone accounted for roughly 6% of the total volume of QQQs on the NYSE. We were animals, with most of our traders doing between 50 and 100 trades a day… and we still had time to take surf breaks every morning. I'd venture to say that we were the envy of most of the other suits in that office building.

During the Internet bubble, we prospered. But unlike most traders, we kept prospering when the bubble burst. In fact, FMB Trading thrived until the implementation of penny spreads and algorithmic trading. This drastic shift in day-trading tactics meant we would have to change our strategies dramatically. At this point, I was quite frankly tired of being a keyboard jockey, and ready for the next step in my master plan.

Around the same time, FX trading suddenly came out of the shadows of the institutional world and became widely available to retail clients. This new market gave me the opportunity to push my trading timeframe out and build an advisory service around it. Once again, though, I encountered a steep learning curve. Day trading stocks is nothing like trading FX. At first, I naively thought I could deploy the same scalping strategy that had been wildly successful for me with trading equities on the FX market. I was wrong. Scalping FX turned out to be a waste of time. This was a game that required more vision and patience. Luckily, I had lots of both.

As I learned the FX market, I learned not to count on instant gratification (sigh). I learned a game that requires planning and conviction, and I was lucky that I had enough professional experience under my belt at that point to learn from past mistakes. I took risks, tinkering and testing various strategies to see what worked best. And after a few months, I was able to put together a trading approach that combined some of the valuable strategies from my day-trading days as well as some technical frameworks to help me analyze data over time and make predictions.

To me, trading is like playing chess: you always have to think a few steps ahead.

Trading is not about being perfect. It's not about being psychic either; you can't always predict where prices are going. But to be a successful trader, you do need to get in sync with the market and learn how to let trends reward you. With each passing year, I have learned more and more about trading. I'm now two decades in, and no longer anguish over every little detail, wave count and forecast. Instead, I let my wisdom and experience lead my intuition — scientifically — when I make trading decisions. Trading, for me, is no longer an intense, pulse-pounding rush. Now, it's a balanced activity and a rewarding, healthy challenge that I look forward to every day.

The Top 10 Reasons Traders Fail

Every trader's goal is to set himself apart from the crowd and avoid losing money. Obviously, not every trader can fall in this winning bracket, so the iconoclasts who do have to set themselves apart from the crowd with smart strategy and a different approach. To be one of the minority who consistently succeeds in trading, avoid making the following ten mistakes.

1. **Looking for a Holy Grail.** Traders who skip around from one method, system, indicator or service to the next in order to find a perfect solution with instant gratification usually end up disappointed. If this describes you, stop right where you are.

2. **Not sticking to a plan.** A methodology, or trading system, is essential. The markets can be chaotic and confusing, especially for someone without a specific plan of action that can be used again and again. Without a plan, you will react to the market instead of anticipating the market. Creating a trading plan is a highly individual process and usually stems from years of experience. Here at Aspen, we have a methodology that allows us to make sense of the market day after day. This is what we share with our clients. We follow this strict process on each and every trade we take, and we pass those trades with the exact stop/entry/exit parameters on to you.

3. **Improper mindset.** Humans are emotional creatures by nature, but being emotional in the uncertain environment of trading can be calamitous. Almost every book on the subject of trading psychology hammers home the idea of more discipline and less emotion. Emotions will inevitably come into play while you are trading. It's how you deal with those emotions that will define you as a winner or a loser.

4. **Improper trade size.** Capital preservation is paramount. Poor account sizing— risking too much per trade— is a surefire way to fail. Trading is not a sprint; it's more like a marathon, and a very long marathon at that. You will lose trades here and there. It's how you deal with losing that matters. At Aspen, we follow strict account sizing rules (which we pass on to you). We tell you exactly how much to risk per trade and exactly where to exit—whether that exit is at one place or multiple places. There is no guesswork for us in trading, which is what makes us successful.

5. **Poor risk-to-reward ratio.** There are two reasons traders end up with a poor risk-to-reward ratio:

   A. They don't have a trading plan and instead simply react to the market.
   B. They simply can't hold their winners… but they hold their losers.

   Having a plan gives you the confidence to see your analysis through to the end. At Aspen, we have a 62% win/loss ratio, and our risk/reward ratio is better than 1:2.

6. **Holding on to losing trades and getting rid of winning trades.** Here we go again: the old "but I don't like to lose" argument. It's human nature to hold onto losses in the hopes that they will rebound. You will have losing trades; get used to that fact. Focusing on how you manage loss—rather than trying to ignore it—will put you ahead of the crowd.

On the flip side, traders often get out of winning trades too early so they don't have to deal with "giving profits back." If you want to lose money trading, holding losses and getting rid of winning trades is a surefire way to achieve it. In trading, it's much more important to be profitable than to be right, and in order to be profitable, you need to cut your losses early and let your winning trades keep working for you.

7. **Thinking of trading as black and white.** It might pain you to hear this, but trading is not a black and white process; there's a lot of gray. Another losing analogy is the "red light/ green light" system. Having a simple 3-step process to help you frame and identify a trade set-up is okay, but experienced traders know that nuance is where real insight lives.

   Some days, trading is indeed A + B = C. Other days, trading is A + B = 1 (or D or F or Z). If trading was A + B = C all the time, everyone would know exactly how to win. This is not realistic.

8. **Overtrading.** This one is simple. If you're trading simply for the sake of trading, you're overtrading. Trade because you see genuine opportunities in the market. Trading is not like a 9-to-5 job where you are rewarded for constant productivity. You don't get paid to push buttons all day long; you get paid by making good, winning trades. It's that simple. Movement in the markets doesn't mean you must trade. Trade when things line up for you. Be patient, wait for setups to occur, and when they do, take action. If you want to succeed at trading, you need to act like a winning trader, and winning traders are patient and wait for setups.

9. **Not taking trading seriously.** I'm often puzzled by how often people approach trading with a different attitude than they do any other moneymaking venture. Trading is a business, and like most vocations, it takes time to learn how to perform well. People go to school for years to become doctors; but many so-called hobbyist traders think that simply reading a few "For Dummies" books or scanning some indicators will suffice. This attitude toward trading is like throwing darts at the wall with a blindfold on. Shortcuts and scams don't work. Trading is not easy, and you can't learn it without effort.

   You can, however, enlist a seasoned expert (like us) to guide you.

10. **Not having a successful mentor.** Any successful trader once had a mentor, coach or service help him to formulate a plan and strategy and learn how to be successful. I am no exception to this rule.

    Yes, there is a lot of free advice available, especially on the internet. You can spend your time sorting through it, guess which nuggets of information are authentic and valuable, and then hope for the best. If you're really an ambitious D.I.Y.-er, you could, in theory, learn to do just about anything with a few books and an internet connection. But will you learn to do it well? And how long will that take, exactly? And do you really have that kind of time and discipline?

    Working with a mentor is a powerful shortcut that helps you tap into proven trading approaches so you can start making money faster. When you enlist a mentor, you are essentially buying knowledge and training that is an investment in your future trading. Over time, as you learn a framework that works, you'll eventually be able to add your own investing twist to it. But like a house, a solid foundation is the very first step. Let Aspen help you build your foundation.

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