Rule’s Based Trading

Introduction:

Have you ever been curious about how real professionals trade? What if I told you it was a simple process. This process is.. Rules Based Trading. This type of trading consists of an objective trading plan that is used everytime we place trades. This not only makes it possible to test a strategy and determine an expected possible rate of return and possible drawdown, but also makes trading very simple. This trading plan consists of everything from, the time that we start to trade each day to the entry, stop and targets that we use each time we place a trade. This short book summary will explain how to start using Rules Based Trading in your own trading journey.

Disclaimer:

Step one:

Trading Time Frames

In this step, you will need to determine the time that you can dedicate to trading. Will you be trading for a few hours a day as a day trader? Do you have access to a computer every few hours? Do you work full time and have very limited access to a computer? All of these factors will effect your trading plan. So, in this step you will be deciding what time frame you have the ability to trade on. Common trading time frames include 15min, 1hr, 4hr, and Daily. The 4hr and Daily charts are common for traders with limited time to view the charts. In this step, you will also want to match your personality with your trading. We will talk more about this in step two.

Step Two:

Trend or Counter Trend?

The next step in Rules Based Trading is to determine what type of trader you are. Now that you have determined the time frame that you are comfortable trading, now is the time to decide how your personality will match up with a trading strategy. This will make a rules based strategy much easier to follow.

Determine what type of trader you would like to be. Are you going to be a trend following trader, a counter trend trader, or both? (it is better to pick one or the other when first starting out) Will you be a swing trader, day trader, or position trader? It will be best if these decisions match your personality. For

instance, if there is a trader who does not like to hold a position over night, then it may suite them best to day trade. So, by the end of these first two steps, you will know what time frame you will be trading and what type of trader you are.

Step Three:

building a strategy

At this point, a trader is ready to start to build out a Rules Based Trading strategy. Use the information that you decided in steps 1 and 2 to start creating this strategy. Pick the correct time frame and type of trades that you will incorporate in your strategy.

Traders have two options for this stage. One, they can scan the markets on different currency pairs and create their own Rules Based Strategy, by looking at price action, indicators and other market conditions to create rules for this strategy. Option two is learning a strategy from someone else or a professional trader that meets the criteria of step one and two. This is a much faster, but still takes time and effort.

There are many other aspects to a rules based strategy that must be considered as well. Such as, rules for entry, stop loss placement and target placement. It is important that these rules are as objective as possible.

Step four:

backtesting

Now, at this point a trader should have a specific set of objective rules for when to enter and exit the market. This will include, the time that a trader can trade, what type of trades he/she can take and objective rules for entry, stop placement and target placement. This strategy has either been created by the trader, or learned from a third party resource.

Either way, in this step, it is time for the backtesting process. Here the trader will take the objective rules created and test them on the correct pairs and time frames. In this process, we look through historical chart data and find all the instances that aligned with our specific rules for entry. After finding that entry, we calculate stop and target placement on that specific trade based on our rules and record the data in a spreadsheet or on paper to asses the possible risk and reward of the potential strategy.

Step five:

Mindset

By this point, after backtesting, a trader will have experience in the market and understand the risk involved in their strategy. Now is time to work on discipline and having the correct mindset.

Traders at this stage now have the correct expectations. They know that this is not a get rich quick scheme. From their backtesting, they understand that trading is a slow and steady process. This is important for discipline. Discipline is the process of being able to stick to your trading plan through difficult situations. Such as, drawdown and at points when the market seems to be against you. Your

backtesting process should have given you the confidence to put your trading plan above all and leave your emotions at the door at the beginning of each trading day.

Step Six:

Risk Management

In the risk management stage, it is important to incorporate your personality in this process of your trading. It is also important to understand the risk involved in trading and never trade with money that you cannot afford to lose. This is in no way advice on how to create your own risk management plan and should be taken as educational information only.

Using the correct risk management plan will play a vital roll in your trading success. Risk management consists of the amount of total capitol that you are willing to risk, not only in your account, but also in each specific trade. This is were a number of traders make mistakes. It is important to remember that trading larger positions, especially at the beginning of your trading career can be detremental for your trading. It is best to start with a very small position size or even trade for a while on a practice account.

Conclusion:

This is the conclusion of the process of Rules Based Trading. At this point, a trader will have a fully written trading plan. This plan now includes, What time the to trade, What type of trades to take, a strategy with objective rules for entry, stops and targets that has been tested in historical data. This testing sample size should have been large enough to give the trader enough confidence to have discipline in their trading plan. Lastly, this trader now has an effective risk management plan that meets his/her personality type and personal risk appetite.

After this process, it is up to the trader to determine the correct time to risk live money in the market.

Visit www.thetradingchannel.net for more information Rules Based Trading. I hope you enjoyed it and if it helped you, or if you have any questions, then email me at steven@thetradingchannel.net