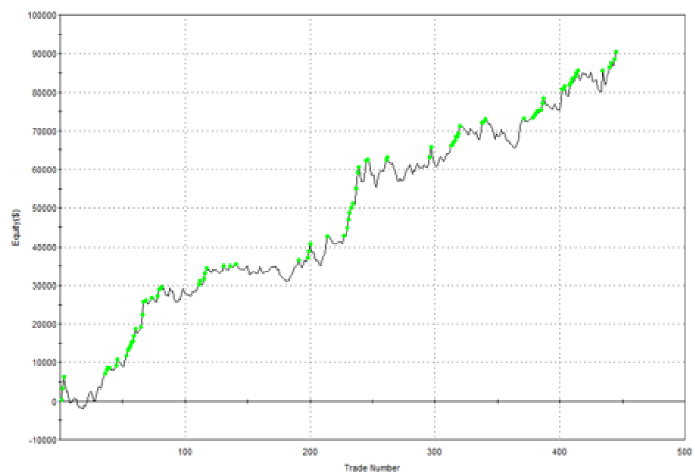

Algo Trader’s Toolkit

Kevin J. Davey

Contents

Disclaimer

U.S. Government Required Disclaimer - Commodity Futures Trading Commission states: Futures and Options trading has large potential rewards, but also large potential risk. You must be aware of the risks and be willing to accept them in order to invest in the futures and options markets. Don't trade with money you can't afford to lose. This is neither a solicitation nor an offer to Buy/Sell futures, stocks or options on the same. No representation is being made that any account will or is likely to achieve profits or losses similar to those discussed in this document. The past performance of any trading system or methodology is not necessarily indicative of future results.

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NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL, OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE DISCUSSED WITHIN THIS SITE. IF YOU DECIDE TO INVEST REAL MONEY, ALL TRADING DECISIONS SHOULD BE YOUR OWN.

Introduction

Welcome, and thanks!

Just by downloading this document, I hope you realize how I am different than the typical trading "educator." Most educators require an e-mail address before they send you their precious report.

What a crock of $#^#^$, and usually a waste of time – how many so-called educators have you given your e-mail to, only to unsubscribe a day later, because you realized they were just knuckleheads?

I refuse to play games like that, so I am giving you this toolkit, and I want nothing in return.

Why?

Because I know that about 87% of serious traders will find a ton of value in this report, and will visit my site and then sign up for my e-mail newsletter (and get even more free information). That is how confident I am in this material. And if you don't find value here, that is OK – at least you haven't given away your e-mail address!

This e-book is really more than a simple document – it is a roadmap to a lot of trading material I have written and produced over the years. You will find more than a few nuggets of wisdom here – bits and pieces of information that I uncovered the hard way – by losing money in the markets!

In the next sections you will find:

- 43 articles on all aspects of trading, from beginner's advice to intermediate tips to in-depth analysis geared toward professional and advanced trader

- 33 videos about trading, everything from how to videos to demonstration videos
- 2 presentation handouts
- 3 High Quality podcasts I was interviewed for
- A bunch of indicators and code snippets I use in my own trading
- Information on how to get advance notice on future free webinars I conduct
- A description of my Strategy Factory Workshop (along with a bonus offer) – a great way to take your trading to the next level

So, without further ado, let's jump right into the material!

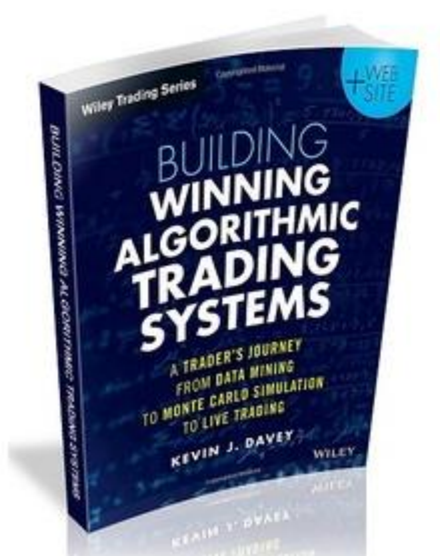
Kevin Davey

Champion Trader

About Me

Kevin J. Davey, Founder, KJ Trading Systems

KEVIN is a professional trader and a top-performing systems developer. Kevin is the author of **"Building Winning Algorithmic Trading Systems – A Trader's Journey From Data Mining to Monte Carlo Simulation to Live Trading"** (Wiley, 2014). An aerospace engineer and MBA by background, Davey has been an independent trader for over 25 years.



Although Kevin has had a great deal of recent success, many of the early years were met with failure. Bloodied but not defeated, Kevin spent the next few years researching, reading and otherwise devouring all he could about trading. That legwork certainly paid off in a worldwide futures trading contest. In the years from 2005 to 2007, Kevin was usually near or at the top of the leaderboard.

- **2005 - 148% return (2nd place)**
- **2006 - 107% return (1st place)**
- **2007 - 112% return (2nd place)**

With a background in aerospace engineering and quality assurance, Kevin brings a unique perspective to trading. Currently, Kevin trades full time, writes for trading publications and gives trading workshops. Kevin also consults for private individuals and CTAs, when he is not developing new strategies for his own personal account.

Almost forgot, apparently Kevin is a little rat, too. At least, that is what one independent trading education reviewer said about him. Click his likeness below to read the review!

Why did a major trading review site call me a dirty rat? Click the rat to find out!

First Things First

Before you take a look at my material, think about what you do not see here: no flashy cars, no sparkling diamond watches, no girls in bikinis, no private jets. In other words, on trader porn!

Unfortunately, many people expect that nowadays, especially when you see all these “traders” on Twitter making tons of money (spoiler alert: most of them are frauds, either trading demo accounts, or trading in “replay” mode).

You won’t see any of that nonsense here. I tell it like it is – trading is hard work.

But I speak the truth, and trading industry awards show that:

MY TRADING COURSE: STRATEGY FACTORY® WORKSHOP

2016 Trading Course Of The Year - Winner!
As voted by the readers at TraderPlanet.com

MY TRADING BOOK: BUILDING WINNING ALGORITHMIC TRADING SYSTEMS

2016 Trading Book Of The Year - Traderplanet.com STAR Award

#1 Best Seller in Online Trading E-commerce

As of Sept 23, 2015

2014 Trading Book Of The Year - Traderplanet.com STAR Award

So, I apologize in advance for the lack of “sizzle” in this trading toolkit. I guess I just want to keep it real…

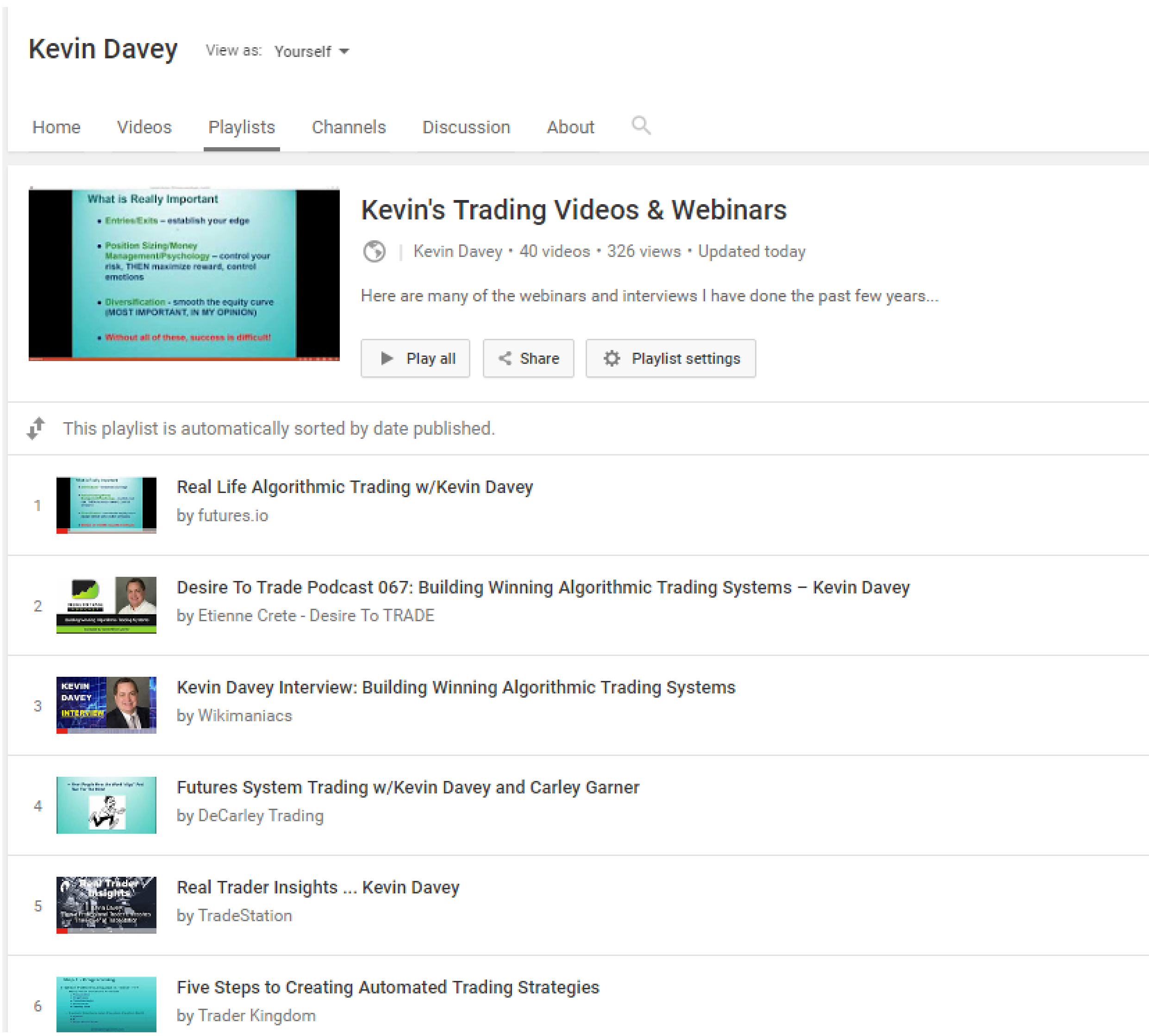
Quick Start

THE 26 HOUR EPIC VIDEO PACKAGE

Get some popcorn and a cold drink, you going to need them both…

I've put together many of my favorite videos, and put them all in one playlist. Over 26 hours of material, on everything from strategy development to position sizing to psychology to money management.

Sit back, relax and be ready to learn!



What Exactly Is “Algo” Trading?

Let’s start our journey at the beginning…

What exactly do I mean when I say “algo” or “algorithmic” trading? Simply put, algo trading is a method of trading where trades are taken according to a set of pre-defined rules.

This type of trading is also referred to as systematic, rule based or mechanical trading. At least the way I define it.

It differs from another major style of trading – discretionary trading – where the rules are fuzzy, non-existent or ever changing, and trading decisions are made by the trader, based on his/her knowledge and experience. Discretionary traders are usually screen watchers, and many of them really on intuition or other factors that are difficult or impossible to verify (other than seeing their trading statements!). Don’t get me wrong – discretionary traders can be successful. My experience, though, is that this style of trading is really difficult, and take a very long period of time to master.

Many people think the algorithmic trading is only done by high frequency trading firms – hedge funds and others who use high speed computers and high speed access to send orders to the trading exchange before anyone else. Many times, these algorithmic trading outfits employ an army of statisticians, PhDs, programming gurus and signal processing experts. These people design algorithms that exploit small inefficiencies in the market.

But, algorithmic trading does not have to be that high speed endeavor many hear about. In fact, I recommend you stay away from trying to replicate what high speed trading firms do. You and I, as retail traders, just cannot compete with these folks. We don’t have the time, money, infrastructure or expertise to fight the high frequency algorithmic trading firms.

The high frequency firms are one reason why scalping for 1 or 2 ticks profit is so difficult these days. Scalpers fight the high frequency algos, and it is usually a losing battle.

Thankfully, there is room for retail traders in the algo world. My experience is that longer terms trades – lasting from hours to days, weeks or months – can be exploited by algorithmic, mechanical trading. This way, we get the benefits of algo trading, without fighting the high frequency firms!

So, algo trading is:

- Trading 100% according to rules

- Can be computerized and programmed into software like Tradestation, NinjaTrader, etc

- Can be calculated manually, as long as the rules are followed

- Can be automated, or traded manually

- Can be historically tested and evaluated. This is key – it is a great confidence booster knowing you are trading a strategy that has worked in the past. It doesn't mean it will continue to work, but all things considered, I like my chances a lot better!

- Is also referred to as mechanical, rules based or systematic trading

Almost all the trading I do is algo trading. After reading all the info in this document, I think you'll see why. If you like to think logically, and make decisions based on facts (and not feelings), then algo trading may be right up your alley.

There are a ton of nuances to algo trading, and this document is not intended to teach you everything. But, reading this material will give you a good idea of what you can expect in the world of algorithmic, systematic, rule based, mechanical trading.

Articles – Part 1

100 PERCENT RETURNS PER YEAR

Don't let anyone ever tell you the futures game is easy. I've been speculating in futures for 25+ years, and it took me most of that time before I had any degree of success. I attribute successful futures trading to following certain steps. My guess is that these steps will work for you, too.

Step 1: Have a Plan

I've never seen someone build a house without detailed drawings, and I bet you haven't either. To build a house, you need a plan. The same holds true for speculating in the futures market. Your opponent, the market, has a plan - to take all your money - so you need one, too.

There are 3 major pieces to a good plan. First, you must be specific with your investment goals. Second, you must determine what you are willing to invest to get it, by identifying the amount of time and money you will invest. Finally, know what you'll risk to reach your goals. Are you willing to spend a year learning, or lose thousands of dollars before you start winning? Better to find that out now, upfront, before you invest the time and effort.

Step 2: Find a Strategy

Finding a viable strategy is the most difficult part of developing a trading system. You might not think that's true, based on ads and infomercials you see, which show you how easy picking a strategy is. Alas, if it were only as easy as going to a free seminar in a hotel or visiting a website! In reality, finding a good strategy involves 3 main areas: skill assessment, research and detailed development.

The first part of determining how to reach your plan is to do an accurate, honest skill assessment. Done correctly, this will point you in the right direction. If you don't do this assessment, you'll be doomed to wander the "land of the losers."

The second component of your strategy is research. Before you settle in on a strategy, you need to see what is out there, what is working today, etc. Keep your mind open, and you'll soon find something that you like, and that has potential.

Finally, it's time to get your hands dirty by doing detailed development. Whether you create a system yourself, or sign up with a service or an advisor, the key is to perform "due diligence." Make sure you learn all you can, before you put real money on the line.

Step 3: Check and Double Check

Remember when you were in school and the teacher always said "check your work?" If you were like me, you thought checking it was something you didn't need. Well, if you avoid checking your work before trading a strategy, you can easily fall into trouble.

Depending on the route you choose, there are many ways to double check your work. It might be as simple as checking your strategy code for math errors, or asking an advisor to back up claims with brokerage statements, or simply asking for references. Remember, it is your money, so take the time to thoroughly check everything out.

Step 4: Execute Your Strategy

At this point, you are ready to pull the trigger, and trade your strategy with real money. The key here is to plan your trade, and trade your plan. Simply put, once you develop a method or select an advisor, stick with it, without deviation, for at least three to six months. Anything less, and random chance could make a good strategy look bad. Give a strategy time to show its long term potential.

Step 5: Monitor and Adjust as Necessary

Once you start trading, it is essential that you monitor your results. One way is by keeping a trading log. Recording the details of trades, along with your thoughts and feelings, can be very helpful when you review your system performance. This log is especially powerful when you violate your system, as you likely will at some point. Reviewing why you violated your system may help you refine your signals to more closely match your psychology. The key here is to keep close tabs on your trading - otherwise, it can quickly get out of control.

Conclusion

So there you have it - the five steps to trading that I have used in my own trading. Don't be surprised if it takes a year or more to move through the steps. My advice is to not rush through them. I obviously can't guarantee that you'll have favorable results, but I can tell you the steps work, and work well.

WHEN TO STOP TRADING A SYSTEM

It is easy to know when to start following an advisor or trading system - start trading as soon as you have determined it is the right investment for you. But, do you know when you'll stop following that new system?

Whether you are following your own trading system, or following an advisory, newsletter or some other service, if you don't have an exit plan for discontinuing it, you should.

Why? Studies have shown that when people are under stress, many times they make poor decisions. Certainly if you were losing money with your systems you would be stressed. Consequently, you might make a knee jerk reaction to the losses, or you may stick your head in the sand and avoid a decision all together. Both scenarios can be dangerous. So, the time when you are losing is a bad time to determine when to exit.

Ideally, you already determined when to stop trading when you first decided to trade the system. If not, it is not too late. Just determine the metric(s) that are most important to you. They could include such things as:

- Maximum drawdown
- Consecutive losers in a row
- Amount lost in a week/month/year
- Overall profit after X months

• Overall winning percentage dips below XX %

• Significant break in your personal equity trendline, or equity moving average

• New highs, or breaking of another "good" metric (yes, some people try to quit at the top)

• Anything that can be measured and monitored

The exact condition you select probably is not as important as writing it down and sticking to it. That is the key. It needs to be solid, definitive and written down. Ideally, you'll also tell your spouse or a friend, too, since it is harder to back out when you make the proclamation public.

I've heard that one money management firm's exit criteria is 1.5 times the maximum drawdown, and a 24 month commitment. Those aren't bad, but the best one is the one that you feel comfortable with - one you can stick with.

You'll definitely worry less about your system's performance if you write down and follow your exit plan - today!

USE MARGIN TO POSITION SIZE?

A new trader I know was lamenting about a futures trading system he was interested in trading. "I like it a lot," he said, "but it holds trades overnight. That means I can only trade half as many contracts, because of the exchange margin requirements. I am trying to trade as many contracts as I can, and I like the lower day trade margins."

I'm sure some of you are reading this nodding your heads in agreement. Is this sort of position sizing a problem? It sure is.

Let me put this bluntly: If you position size based on minimum margin requirements (i.e., maximize the amount of contracts or lots to trade) in ANY futures or forex market, eventually you most likely will lose all your money, because you are overtrading. Your risk of ruin becomes huge when you overtrade or overleverage.

How do I know this? 1) I've blown out accounts doing this myself, and 2) margin requirements are determined by the exchanges, which have nothing to do with your particular trading method. How can you base your position size on a number (margin required) which knows nothing about your particular potential losses and drawdowns?

So, how should you position size? There are numerous position sizing methods out there, and many good books on the topic. The key is your position sizing should reflect your tolerance for risk and reward, and should incorporate characteristics of your particular system. For example, if you knew your tolerance for maximum drawdown was 50%, you could take that requirement, combine it with your system's trade history, and run a Monte Carlo analysis to determine the appropriate position sizing technique.

One key to survival I've found over the years is not to overtrade. Trying to maximize the position size based on minimum margin requirements is definitely overtrading.

WALKFORWARD TESTING

If you've been around trading for a while, you probably have seen system vendors tout their performance results via "backtest" or "walkforward test" reports. Unfortunately, most people think these two types of tests are the same, or virtually the same. Nothing could be further from the truth.

So, what is the difference between backtests and walkforward ("out of sample") tests? In a nutshell, with traditional backtest optimizations you take all data, optimize your parameters and then take the best parameters and start trading it. Traditional backtesting produces an excellent looking, almost-to-good-to-be-true equity curves for the past, but rarely works as well going forward. This method is what you typically see in ads, proffered many times by unscrupulous system sellers.

Walkforward, on the other hand, takes a small chunk of data, optimizes the parameters, and then applies those values to the next chunk of UNTESTED data. Those new results become part of your final results, one piece at a time. Since walkforward testing calculates the performance on untested and unoptimized data, walkforward is a truer indication of future performance.

If you are looking at any track record, first and foremost, look for real time, audited results or those linked to actual trading accounts. Nothing is more realistic than that. If actual results are not available, walkforward results are the next best thing. Compared to real time performance, walkforward results will usually be somewhat optimistic, however.

Backtest results, on the other hand, are typically so full of hindsight, over-optimization and curve fitting that these results should be VERY carefully scrutinized. Many times, backtest results are so full of intentional or unintentional errors that the results are worse than useless. If the results look too good to be true, they probably are.

So, be careful when looking at performance results.

Take the time to understand what you are looking at, and how it was created. Look for real time results first, then walkforward results. Beware of backtest results.

Here's a picture that describes the process:

TRADITIONAL OPTIMIZED BACKTEST

Perform steps in sequence

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	In sample optimization dataset (optimize parameters with this data)													
2												Live Trading with optimized parameters		

Major drawback: parameters optimized on past rarely work good going forward

WALKFORWARD OUT OF SAMPLE TEST

Perform steps in sequence

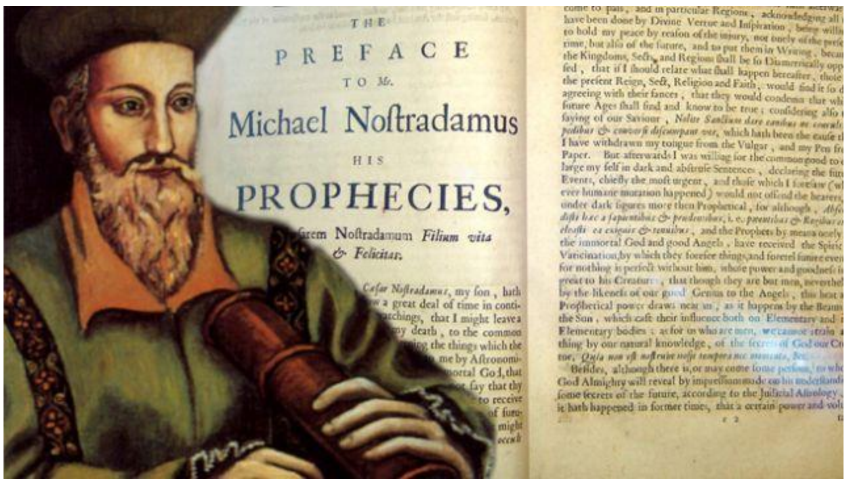
If results of OOS (Out of sample) tests are positive, continue to live trading

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	In sample optimization dataset (optimize parameters with this data)													
2						OOS 1								
3		In sample optimization dataset (optimize parameters with this data)												
4							OOS 2							
5			In sample optimization dataset (optimize parameters with this data)											
6								OOS 3						
7				In sample optimization dataset (optimize parameters with this data)										
8									OOS 4					
9					In sample optimization dataset (optimize parameters with this data)									
10										OOS 5				
11						In sample optimization dataset (optimize parameters with this data)								
12											OOS 6			
13							In sample optimization dataset (optimize parameters with this data)							
14												Live 1		
15								In sample optimization dataset (optimize parameters with this data)						
16													Live 2	
17									In sample optimization dataset (optimize parameters with this data)					
18														Live 3

Major drawback: difficult and time consuming without special software

DID NOSTRADAMUS TRADE FUTURES?

If you've been trading futures, commodities or forex for any amount of time, chances are you've heard the phrase "past performance is not necessarily indicative of (or no guarantee of) future results." It is a government mandated statement that is required for groups involved in certain trading activities. And as you'll see, it is required for very good reasons, and to answer the headline question - no, past performance does NOT predict future results.



This warning statement/disclaimer is mandatory in many situations because most people look at a historical performance record or equity curve, and extrapolate the results into the future. For example, if an investment made 40% average per year for the last 5 years, many people will assume it will make 40% for the next five years - or at least for the next 1-2 years. That is the absolute WORST thing to assume, for two reasons. First, the future is never a repeat of the past, and second, the historical record itself might be flawed. Both of these problems are discussed below.

Even though it is obvious that no one can predict the future, people always do. This happens in all walks of life, and shows up in such diverse activities as weather forecasting, fortune telling, sports championship predictions and stock market calls. Although it is fun to predict the future, no one really can with any accuracy (although many will claim they have that "gift" - if they really have this ability, how come they are not multi-billionaires?).

So, a typical way to predict the future is to use the past as a guide. For example, the Pittsburgh Steelers won the Super Bowl last year, so based on past performance, they should win it all this year. Or, maybe in late 2007 you thought that since the "buy and hold" method for stocks worked from 1910-2007, it should work in 2008 and beyond. See the problem? Knowing the past doesn't necessarily help us with the future. Many times it blinds us to other possibilities, which many people found out during the 2008 financial crisis. And that's one reason for the government warning.

A second reason for the "past performance is no guarantee" disclaimer is that, especially in the investment world, the performance curves and figures that are shown are many times hypothetical (meaning, no one actually traded that way with real money, and possibly no one even COULD have traded that way, even if they wanted to), or developed with the benefit of hindsight (improper "backtesting" is a good example). Therefore, the performance you are looking at might have absolutely ZERO relevance going forward.

So, how can you protect yourself? First, if you see someone making market predictions, realize that there is a good chance they will be wrong. No matter who the guru is, take any prediction with a grain of salt. No one truly knows the future.

Second, investment track records are nice to look at, but never assume that the past performance shown will be repeated. It rarely is. However, a track record, especially if it is audited by an independent third party, may help give you confidence that the people running the investment know what they are doing. That is certainly better than putting your money with someone who has no track record. But again, it is no guarantee of performance going forward.

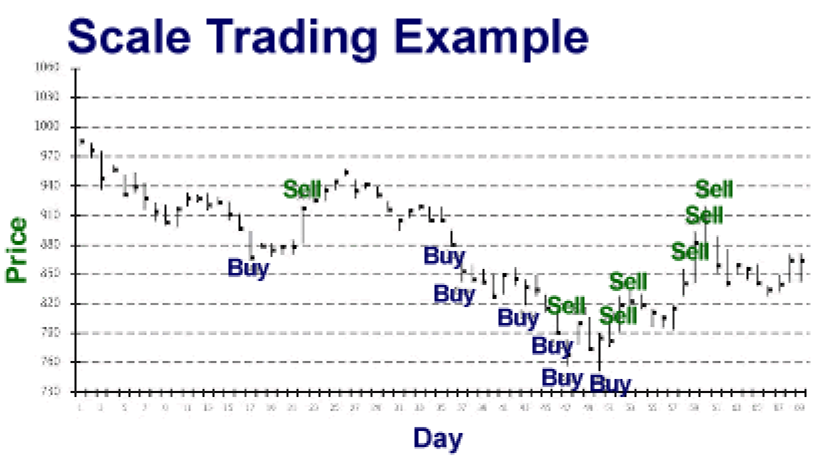
Third, for any track record you see, ask if it was produced in a real money account. If it wasn't, it still might be a viable investment strategy, but treat it with healthy skepticism. It might be a pie-in-the-sky trading method that is impossible to achieve in real life. Or, if it was produced with hindsight, it is almost a guaranteed loser going forward.

Finally, make sure you perform due diligence before buying any system, following any guru or signing up for any signal service. It is your money, and you worked extremely hard to accumulate it. Don't throw it away on a snap decision. Take the time and the effort to research and investigate every investment opportunity in detail. If you rush and fall for the best sales pitch, soon enough you'll learn why there is the required warning "past performance is no guarantee of future results."

SCALES - HAZARDOUS TO YOUR HEALTH

I have been trading futures for over 25 years, and many of the early years were consumed with searching for the "perfect" trading system. One of the approaches I found that seemed to make sense was scale trading. It is an interesting concept that "wins" most of the time, but is really only appropriate for those with very deep pockets who can stomach occasional enormous drawdowns.

In a nutshell, scale trading buys futures in a physical commodity as it approaches a "bottom," and sells at small profits. So, for example, you might decide that wheat is near a bottom, and buy each time the price drops down by 10 cents, which is $500 nominal value for one Chicago Wheat contract. On the sell side, you might decide to sell each wheat contract 5 cents above what you paid for it, for a $250 gross profit.



So, since you always wait for prices to recover, nearly every trade is eventually profitable, and the winning percentage is very high. This high winning percentage, typically over 90%, is what lures many unsuspecting traders in.

With scale trading, you are betting that the laws of supply and demand will eventually cause wheat, or any other physical commodity, to increase in price. As the price increases, you'll bank a small profit on each contract you purchase and later sell.

As you might have guessed, the big problem with this "adding to losers" technique is that you do not know where the exact bottom is, or when prices will recover. In the worst case, you'd have to keep adding contracts, and hold them for possibly years, rolling them over every few months and incurring costs along the way. The laws of supply and demand tend to take time to work, usually months to years. Just because wheat is low today does not mean it will absolutely be higher next month, next year or even five years from now.

Financially, scale trading as a strategy is doomed, if you misjudge the situation and start buying contracts a long way from the bottom. As the price descends, you could find yourself easily holding 10 or more contracts, which is a big problem unless you have deep pockets, and can afford to wait.

Psychologically, scale trading is a killer because you may find yourself fighting a downward trend, and adding contracts as the situation gets worse. It is basically refusing to admit you are wrong, and backing up that refusal by digging a deeper hole.

I can tell you from personal experience that scale trading works when you anticipate the correct bottom, and start buying close to that bottom. But, I can also tell you that if you estimate the bottom incorrectly, you will run out of money, patience, or both, before you turn a profit. That's what happened to me - after some initially success, I suddenly lost my ability to pick bottoms, and quickly wiped out my account.

So, be careful if anyone ever suggests scale trading. Like many other approaches, it can work if you execute it flawlessly, but if you don't, you could find yourself in a deep financial and psychological hole.

THE LEVERAGE BEAST

I'm sure you've seen ads from forex or futures brokers touting the incredible leverage you can have trading. While it is true that leverage is great when a trade moves in your favor, it can wipe out your account in an instant when it goes against you.

For example, many forex brokers offer 100:1 leverage on forex trades. Some even offer 400:1 leverage, but since 100:1 is extreme enough, we'll stick with that for this example.

So, let's say you purchase 1 standard forex lot on the Euro to US Dollar (EURUSD). You are hoping that the price will go up, so you can sell at a profit. 1 standard lot has a value of $100,000, and you only need $1,000 in margin to make that trade. Every pip that the trade moves will mean a $10 profit or loss.

At this point, you might think, "well, $10 per pip is only 1% of my account, so that is a pretty small number. My risk isn't that high." But, in an average day, the range (the high minus the low) of the EURUSD pair is about 100 pips, or $1,000. And during the financial crisis of 2008, the daily range was as high as 480 pips, or $4,800!

Therefore, on any given day, you could easily gain or lose thousands per day. While the thought of making $1,000 on a $1,000 margin deposit is no doubt appealing, think of the downside. You could easily lose ALL your margin (and then some) in a day. That doesn't sound quite as appealing, now does it?

What should you do to avoid this double edged sword of leverage? Simple - if you think you have any kind of tradable edge, trade it at first with very small leverage, for example

2 to 1. In the forex example, that would mean you would need $50K to open 1 standard position, which obviously isn't very palatable to those with small accounts. But, the point is if your system does not work, high leveraged trades will only wipe you out sooner. Why throw your money away until you know you have something that works?

Remember, you are joining a game where 90% of people lose. Your best chance of success is to trade small until you know you have an edge, then when you feel comfortable, you can increase the leverage you use. Using high leverage right from the beginning is a quick way to eventually, and almost inevitably, blow your account out.

THE TWO PERCENT RULE

In the classic book "Market Wizards," one of the famous traders interviews recommends that traders risk no more than 2% of their capital on any one trade. Any amount higher, the expert trader proclaims, is akin to being a cowboy gunslinger.

Although everyone's circumstances are different, in general this is a very good rule. Why? Well, risking only 2 percent of one's account per trade makes it very difficult to get wiped out quickly. As most people probably know, most new traders get wiped out in their first year. Keeping each individual loss small is one way to stay in the game, and give your trading method time to produce profits.

So, how can a new trader with limited trading capital respect this 2 percent rule, and still be in the trading game? Basically, there are three ways:

1) Trade e-minis, mini or micro forex lots, or a very small number of shares of stock. The benefit here is that you can participate in the market, without the risk of a full lot size or large amount of shares. The drawback is that your account equity will grow very slowly, and likely you'll get bored and want to trade bigger. But, it is a good way to start building your capital.

2) Trade with very tight stops. On a $10,000 account, 2% would be $200. So, that would be the amount you'd calculate your stop for. The major problem with this method is that the stop point may be so near your entry that even minor random fluctuations will stop you out with a loss. In addition, commissions and spreads now take up a significant portion of this loss amount. A $20 commission leaves you with only $180 in allowable adverse price movement - not good. With tight stops, you might not lose all your account in a few trades, but you probably will over a larger number of trades.

3) Accumulate more trading capital. Most people wanting to trade hate this one - trust me, I get enough e-mails from people who have $500 or $1,000 and want to trade. I tell them to get more capital, and they get mad. But never once has someone come back and "I ignored your advice, started trading with $500, and am now a millionaire," although I'm sure it can be done (If you do it, please send me your photo, and I can add it to my photos of Bigfoot and the Loch Ness Monster). While you are gathering more capital, you won't be actively trading, but you can still be involved with trading. Research, following the markets, and developing trading methods are all trading activities you can do without actually trading. And what you learn during this time will probably save you thousands of dollars in the long run.

When famous traders make bold statements like "risk no more than 2% on any one position" chances are you should listen to them. There is a reason they are famous, and most of the rest of us are not.

WHEN LIGHTNING STRIKES

In today's electronic age of trading, everything seems very easy. Just log on, point and click, and viola! - a trade is opened or closed. Pretty simple.

But, lurking under that simplicity is a huge hidden danger - what do you do when things go wrong? Technology and infrastructure sometimes fail, and inevitably when they do, it will likely cost you money if you are not prepared. It only takes one position that you can't close to go against you to do major financial damage.

If you don't have a plan for dealing with trading related disasters, you need one. And it should include, at a minimum, backup or contingency plans for your broker, your trading signal provider (if you have one) and you. Each of these areas is covered below.

Backup Plan for Your Broker

At a minimum, you need to have the phone numbers at the ready for your broker, in case you cannot connect to them via the Internet. This should include both an 800 number, and a non-800 number. Sometimes, 800 numbers go down, or may be swamped with other callers. Having a fax number for the brokerage is another option if those numbers are jammed, since most customers would never even think to use it.

Another possible backup idea is to have accounts at multiple brokerages. Then, if you need to enter a position, but cannot do so at your primary broker, you can enter it at a backup broker.

Any good broker will have their own backup plans to deal with their internal problems and connecting with the exchange, so you don't have to worry about that part. Just make sure that you can reach the broker when you need to.

Backup Plan for Trading Signal Provider

If you utilize a trading signal or recommendation provider, or a subscription service, make sure you know how to get a hold of these people in an emergency. Websites and e-mails are great, but in an emergency it is nice to have a vocie to talk to. One missed signal could cost you a lot.

Most good signal providers are willing to go the extra mile to make sure you get the information. One I know of recently text messaged the subscriber every day for a week, just to ensure the data was properly received!

Backup Plan for You

Don't underestimate the significance of having proper backup plans for yourself. For example, if your computer crashes, do you have a backup ready to go? If your primary internet connection fails, do you have a quick alternative? If your phone line fails, do you have a cell phone nearby? If your power goes out, do you have battery backup? And what about you - if you can't enter orders, is there someone trained that can?

Depending on your trading style, you might need to consider some or all of these questions. The backup plan for you doesn't have to be complicated, but it should include all of the bad scenarios you can think of.

In Closing

Unfortunately, most people do not think about disasters and backup plans, until it is too late. It is sort of like backing up your hard drive - most people don't think about it until the drive crashes and data is forever lost. By then it is too late.

Making money trading is hard enough to do when everything is working properly. Don't let the lack of a disaster plan make things even tougher for you.

ALL THAT GLITTERS IS GOLD

I smiled a little bit the other day, when I saw the grumpy old men excitedly engaged in a conversation. I couldn't hear all of what they were saying, but based on the animated pointing and gesturing at what looked like a paper price chart of Gold (they still make those?), I knew it could only be one thing: Gold fever. And as a professional speculator, I knew good things were likely on the way for me. It turns out that extreme public interest is a good sign of a top, at least a temporary one.

Nothing in the futures market captures the capitalist imagination quite like Gold. Ever since the run up in the early 1980, amateurs have been waiting for the price of Gold to explode again. Waiting and hoping, with a fistful of dollars they want to quickly double or triple.

And it is true - you can make a lot of money fast with Gold, especially Gold futures. In just the last 6 months, if you held only one contract of Gold, you would have made about $17,000, which for most people would easily double or triple their account size.

But, don't forget that the futures market is a zero sum game - not including commissions, for every dollar someone makes, someone else has to lose it. And if the people losing recently are professional traders, you can be sure that they are waiting for the right time to get it all, and then some, back.

Like a good hunter setting the proper trap, professional speculators are lying in wait with their bag of tricks:

Obvious Trend Up - when everyone can see the trend is up, it makes it very easy to think like the crowd and join them in buying. The thinking among new traders is that the sky is the limit for the price of Gold. Professional traders know all trends end, and they already have their trading plan in place for when that happens.

Heightened Volatility - For small fry, newbie traders with small accounts, high volatility is a killer, both financially and emotionally. And professionals know that. There is only so much up and down price action a small trader can take, before just giving up entirely. And usually, the small trader gives up right at a turning point - the worst time.

Classic Chart Patterns, Technical Indicators - Maybe it is a range breakout, support/resistance lines or a simple moving average crossover, but pros know exactly what most new traders are looking at for both entry and exit. Knowing in advance when many people will enter or leave the market is a tremendous advantage. So, rest assured that whenever you get in or out, some professional will already have figured that out.

Now, I can't say the professionals are responsible for these tricks, but they certainly see them. Plus, they know how most new traders react to them, and they have a concrete plan to take advantage of it. Do you think the old guys in the coffee shop have an exit strategy already figured out?

The key point to remember is not to get caught up with Gold fever, and realize that you likely will be trading against people who do this day in, day out, and have done so for years. They are pros at taking the money of new traders. Having been a new trader once, I speak from experience on this.

So, if you are thinking of entering the Gold market for the first time, be very cautious. There are a lot of traders who know you are coming. And they are smiling.

FORGOTTEN NUMBERS

When evaluating a futures or forex trading system or method, probably everyone first looks at annual return, since that's ultimately what it is all about. But only the most naive would base their decision SOLELY on annual percentage return.

Why? Annual returns, by themselves, include no information about the risk involved to get that return. For example, would you rather have A) 5% per year, from a bank CD, or B) 5% per year, from highly leveraged speculation in soybeans? In this case, the answer is obvious. The key point is that returns matter, but the path used to get those returns is also important.

One number that new traders ignore, or usually do not put enough emphasis on, is maximum drawdown. Drawdown is the difference between the peak equity and the current equity. So, for example, if you had a maximum account equity of $10,000, and now have only $6,000 in your account, you currently have a 40% drawdown. Maximum drawdown is the largest percentage drawdown the account has had historically.

Maximum drawdown gives you a very good indication of the "pain" you'd have to endure to achieve the annual returns the trading system provides. The problem with maximum drawdown is that it is historical. As we all know, past performance is no guarantee of future results. Thus, the future maximum drawdown might be much greater than the historical maximum drawdown.

One caveat: beware of those who report drawdown based on closed trades only. Many times, people let losing trades stay open, and do not count them in the statistics. Your account equity, however, doesn't know the difference between open and closed trades. An open loss impacts your equity the same as a closed loss. So, make sure any drawdown numbers you look at include currently open trades.

A second performance number that new traders rarely look at is the Calmar ratio. Although there are numerous variations and twists to it - refer to sites such as investopedia.com for details - in its simplest form, this number is the ratio of annual returns to maximum drawdown, over the past 36 months. If you had a 50% annual return, with 25% maximum drawdown, the Calmar ratio will be 2.0. Legendary trader Paul Tudor Jones says a long term ratio of 2-3 is very good. So, this single number tells you a lot, and is excellent for comparing different trading techniques.

Certainly only the newest of traders would look at only annual returns when evaluating an investment opportunity. There is much more to evaluation than just annual returns. By including maximum drawdown and Calmar ratio in your evaluation arsenal, you will be much better prepared to properly scrutinize opportunities that come along.

WIN AT ALL COSTS?

We all have the need to be right. Think about when you were in school - you did your best to be right, and you were graded on your efforts. You took standardized tests to measure how right you were. All your life, you have tried to pick the right career, the right spouse, the right place to live. Everyone wants to be right.

But being right doesn't matter - at least when it comes to trading. In fact, trying to be right by having a high percentage of winning trades is usually a recipe for disaster.

When evaluating trading systems, many people first look at winning percentage (degree of "rightness"). They will, out of hand, dismiss any system below their objectives, which is typically 75% wins or higher. Worse yet, many people will try to be right by refusing to take a loss. Unfortunately, losses left open tend to get larger and larger, making the situation even worse.

Why is looking at winning percentage alone dangerous? Perhaps an example will help. Take 2 trading systems - in trading system A, 90% of the time you win $1. The other 10% of the time you lose $10. In trading system B, 10% of the time you win $10, and 90% of the time you lose $1.

Most people will select system A, since it wins 90% of the time. After all, who can handle winning only 10% of the time?

While it is true that low winning percentage systems are hard to psychologically handle (it is not easy being wrong 9 times out of 10), sometimes those are better long run systems.

How do you know? A simple calculation called "expectancy" tells you. Expectancy is calculated as follows:

Expectancy = (% win * avg win $) + (% loss * avg loss $)

% win = winning percentage, expressed as decimal
avg win $ = dollar value of average winning trade
% loss = losing percentage, expressed as decimal
avg loss $ = dollar value of average losing trade (must be less than zero)

To standardize it, many people then divide this number by the absolute value of average loss. This is commonly referred to as the "Tharp Expectancy."

The important thing with expectancy is that if it is less than zero, YOU HAVE A LOSING SYSTEM. Look again at the example above. Trading system A has a negative expectancy, but system B has a positive one.

If the long term expectancy of the system or method you are trading is less than zero, you will eventually lose all your money - guaranteed! One example - every game in Las Vegas has a negative expectancy for the player.

So look more at expectancy, and less at winning percentage. It is no fun being right most of the time if if leads to the poorhouse.

FOCUS ON THE NEGATIVE

With almost every decision in life, people tend to focus on the positive, and minimize the negative. Think about buying a house - what entices you first? Usually, it is curb appeal, and if your first impression is favorable, you'll tend to minimize negatives, like maybe the amount of rehab the house needs on the inside.

It is the same thing with trading systems or strategies. Most people tend to focus on the rate of return, or maybe even the winning percentage, and if that looks good, they'll downplay the negatives, like the drawdown. For those of you who do not know, "drawdown" is the amount of money lost from the highest equity point. It might be a temporary loss, but you'll have to endure it if you trade the system. Low drawdowns are best, but they are usually tied to low returns (think of interest on a bank account).

When looking at a trading system, signals, or service, your focus should be on downside risk - drawdown, for example, is a great way to measure it.

Drawdowns are extremely difficult for people, especially those among us who follow an advisor or trading signal recommendations in a web service or a newsletter. Since the subscriber did not develop the system (assuming there even is a "system," not just random selection of trades under the guise of an established method), they do not know what to expect. The only thing they can see is what is shown in the trading record, which is usually only a small snippet of time in the system's history (if the developer did the right thing, and used at least a few years of history to test out his idea).

And, if that record is not independently verified and auditable, then even that history should be regarded with suspicion. There are plenty of services out there that independently verify trading records, and they are definitely worth using.

So, what is a good way to evaluate a trading system, newsletter or service? Here is what I'd recommend to potential subscribers of ANY system:

1. Make sure the trading history you see is actually representative of what is being traded today by the developer. There are a lot of knucklehead developers who will significantly change a system midstream, yet keep the same system! So, when you look at an equity curve, you'll be seeing the combined results of 2 or more systems. That is ridiculous at best, misleading and unethical at worst.

2. Before you subscribe to any service or system, find out what the historical maximum drawdown was. As a rule of thumb, multiply that by 1.5. Could you handle that amount of drawdown right off the bat? If not, then you shouldn't subscribe.

3. If you have the ability, put all the trades in a Monte Carlo Simulation and see what shakes out. Monte Carlo simulation is a technique that introduces randomness into future trading results - since the past is never repeated exactly, it is a good way to simulate possible future results. You will be able to see drawdowns in terms of probabilities. So, for example, you might find out that trading system X has a 50% chance of having a drawdown greater than 30% in the first year. It may have this severe of a drawdown, it may not, but the point is at least you'll have some better data to go off of.

4. BEFORE you subscribe, determine your walk way point, and stick to it. Your thinking might be like this:

"I checked with the developer, and he has not changed his system since introduction. A check of his trades confirms that he is trading the same way he always has. His independently verified records show he had a 20% drawdown. Developer's hypothetical history shows a 25% drawdown, and Monte Carlo sim shows a 50% chance of a max drawdown of 30% in the first year. So, I'll take the worst case of them all, and multiply by 1.5. That gives me 1.5*30 = 45% drawdown I should be ready for. That is too much drawdown for me, so I either need to add capital to the account, or not trade this system. Looking at the results, if I double my initial capital, I still get a very good rate of return, and I can withstand a 22.5% drawdown. If that drawdown gets hit, I am out - NO QUESTIONS ASKED. Otherwise, I stick to the system!"

The major point is: don't be sucked in by the fancy curb appeal of net profits or rate of return. Dig deeper, and look at the potential risk, especially drawdown. It takes more effort, but in trading there is no easy way out. Those who try the easy way usually end up losing all their money.

PUT YOUR MONEY WHERE YOUR MOUTH IS

If you are looking at purchasing or leasing a trading system, or looking at following a publisher's trading signals, a legitimate question to ask the vendor is "do you trade this with your own money?"

While the answer to this question can be illuminating, and assuming you get a truthful answer, is it really important if the vendor trades with his own money?

For 100% mechanical systems, I'd say absolutely yes - the vendor should trade that system with real money, and should be able to prove it via independent accounting audits, brokerage statements or third party verified results. Asking for statements might work, but watch out - they can be easily Photoshopped. I'd be seriously concerned if a vendor didn't trade a 100% mechanical system with real money. After all, if the system is so good, why wouldn't he or she trade it with real money?

But, there could be good reasons why a vendor would not trade a 100% mechanical system. For example, maybe the large capital requirements put it out of the vendor's reach. Or, maybe the system requires a fast internet connection, and the vendor lives in a dial up area.

At the same time, however, a vendor who does not trade a 100% mechanical system raises many red flags. Is it because the results are unobtainable in real life? That could be the case for a scalping system. Or, maybe the vendor has no trading capital because almost every previous system he traded with real money failed. That is true more than you'd like to think.

For discretionary systems (ones where some or all of the decisions are made by the vendor, not by a set of definable computer instructions), I'm not as convinced, and I'll tell you why. The emotions of making and losing real money can very easily cloud one's judgment. I've seen good discretionary traders go "bonkers" when something terribly good or terribly bad happens. When real money is on the line, some people become reckless (trading like crazy), and some become timid (not trading at all). Maybe they would have made better decisions if their real money wasn't at stake. Maybe they would have made better decisions - who knows?

What I would recommend if you are interested in a discretionary system is to ask the following questions:

A. Do you trade this with real money (and how much)?

If answer to A is yes:
B. What, if anything do you do to control your emotions while trading? Do you work with a trading coach? Do you think emotions are important?

If answer to A is no:
C. What is preventing you from trading with your own money?

These questions should help you get in the discretionary trader's head, and then you can make a better decision.

There are many questions you should ask before buying any type of trading advice, be it a computer program, "black box" system or trading signals. The question "do you trade this with your own money?" is worth asking, and should definitely be a part of your due diligence investigation.

THE 90 PERCENT CLUB

If you've been around investment circles long enough, you have undoubtedly seen ads for stock, futures, forex or commodity systems, services or newsletters claiming a 90% or greater winning trade rate. This, of course, makes the approach very enticing. I mean, seriously, how could you lose money if you win 90% of the time?

In other articles, I've provided the math behind how to really evaluate a system, which includes winning percentage, average win and average loss, so I won't repeat it here. Instead, I'll focus in on the 7 ways someone can claim a 90% winning rate, and what you should watch out for:

1. Mr. Hindsight
This person can point to any chart, and identify his buy and sell points with absolute precision. Usually recognized as an expert in his field of analysis, he can create stunning buy and sell signals for past data. Problem is, he usually can't do it going forward. ADVICE: Ignore past "predictions," and only follow Mr. Hindsight in real time. You'll soon see his true ability.

2. Ms. Vague
Her market predictions are akin to reading the works of Nostradamus. She'll say "the market will be up today, unless GDP figures are disappointing." After the numbers come out, the prediction can be made to fit the outcome - "well, the numbers were only somewhat disappointing" or "other forces overpowered the market, so even though I was right, the market fell." ADVICE: Turn off financial TV shows, since this is where Ms.

Vague and here cohorts lurk.

3. Mr. Sneaky
This guy will have an ad that states "95% winning closed trades." Sounds great, BUT it usually means that 5% of his trades are currently open losers, usually big losers, that he has held onto for a long time. ADVICE: Make sure all open trades are disclosed, too. Treat open and closed trades as the same. Don't fall for the "this losing trade can always come back and be profitable" ploy.

4. Ms. Quick Exiter
In and out like a flash on winning trades, Ms. Quick Exiter will typically have losses 5-10 times her winners. But, she gets a lot of winners, and she wants to dazzle you with winning percentage. ADVICE: Look at total net profit. You probably will see a losing strategy, even with a 90%+ winning percentage.

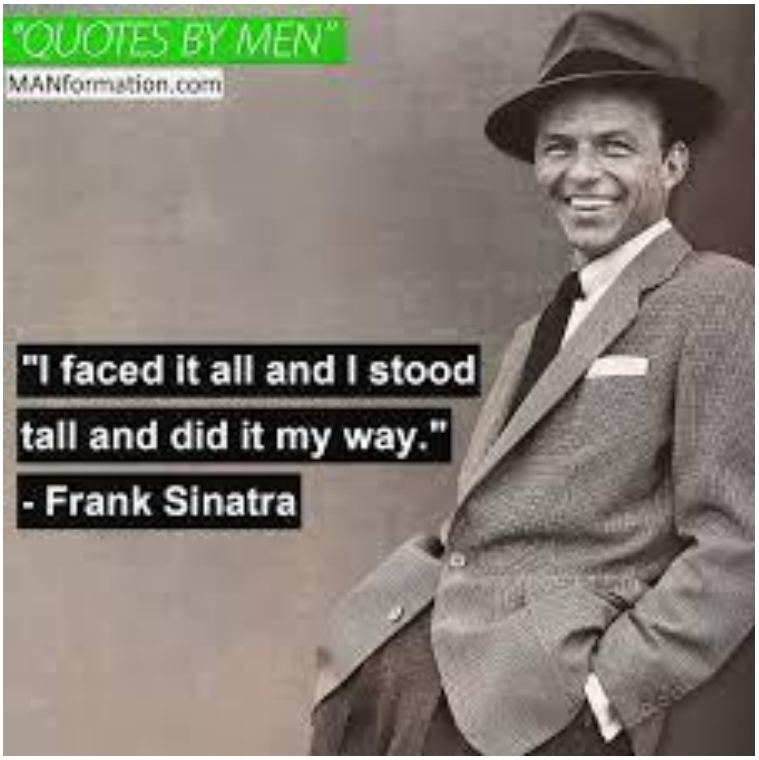
5. Mr. Liar
If Mr. Liar can do anything to cheat, he will. In the past, he has stuck all his losing trades in one account, put all his winners in another account, and of course, only shows you the winning account. But, he has many other tricks up his sleeve, certainly more than I can name here. ADVICE: Track his trades in real time. Make sure they are specific and detailed enough so they cannot be misinterpreted.

6. Mr. Long Term
"The stock market will rise," says Mr. Long Term. He is absolutely right, if you don't pin him down on time. It may take 100 years, but stocks will eventually rise. But, the first 99 might wipe you out. Long term forecasters hope you'll forget their predictions if they are incorrect. ADVICE: Treat any prediction, especially long term ones, with extreme suspicion. The fact is most experts are just guessing.

7. Ms. Really Can Do It
A rare and exceptional talent, this person is the real deal. No gimmicks, no tricks - just super high winning percentage and super high profits. ADVICE: Ask yourself "why would this person sell me their amazing secrets for $79, when if she is so good, she can trade and make unlimited amounts of money?" Answer: No one will ever sell you the ultimate key to trading success, and if they did, it would cost a lot more than you could afford.

So, now you know the seven members of the 90% winning trade club. Avoid these folks, and you'll almost certainly become a better trader.

I DID IT MY WAY



A while back, I received an e-mail from a relatively new trader. He was trading a system he purchased, based on its alleged stellar performance. "I've been using this system for a few weeks, and sometimes I just KNOW the signals it gives will be wrong. What do you think if I'd take the signals, and combine them with work of my own, to get modified signals?"

Here is what I told him...

Obviously, since you bought the system, you can do whatever you like with the signals, since the final decision to trade or not rests with you. The signals are only a recommendation - you control what happens in your trading account. Don't underestimate the magnitude of this fact.

I can tell you that in systems I develop, I use the signals AS IS, with zero modifications. I trade most of my systems fully automated, where it is almost impossible for me to interfere. I'm not smart enough to know when the automated signals will be good or bad, so I've taken myself out of the equation. It is funny, but the days I think "why did the system go short/long TODAY?" usually turn out the best - the system is typically right, and my "hunch" is usually wrong.

But that's me. I make sure I have the confidence in the system BEFORE I start trading it. It sounds like you need to develop that confidence, too. Here is how to get it:

1. Only buy systems or follow signals from trading system developers you trust. Ask a lot of questions before you buy. Establish a general comfort level.

2. Evaluate the historical performance in detail. Can you trade that type of system, whether it scalps, swing trades or position trades? If the system adds to losers, will you be able to always do the same? Do the historical results look too good to be true? That's a tipoff that the system might have been curvefitted or over optimized.

3. See if you can track the performance in real time for a month or so, before you buy. It is amazing how many systems that look good today will look terrible after another month's worth of real trades. Treat this as a "cooling off" period to prevent buyer's remorse.

4. If you decide to buy, start small. Give the system a chance, but with limited capital. You'll quickly find out if the system is something you can handle, both financially and psychologically.

5. Once you are ready to go "live" with full size trading, and you've satisfied all the conditions above, NEVER override a signal, unless you have the ability to fully backtest and evaluate it yourself. Modifying signals on a whim or a feeling is almost like flipping a coin - it rarely gives you any kind of extra "edge."

Here is another way to think about modifying system signals: you can buy a new car and modify it to get better performance. It might work much better for a short while, but then maybe the engine will seize (and maybe it won't). You just don't know. It is the same thing with modifying or overriding signals from a system - you might make improvements in the short term that really hurt the long term performance. You just don't know.

Because of the possible unintended and unknown consequences, I recommend, for systems you believe in, that you follow signals as is. The key is to believe in the system before you buy.

THAT'S A SNEAKY TRICK

I saw an advertisement for a futures trading system the other day, and I'd thought I would discuss it here.

Now normally, I trade only futures, forex and commodity systems I create, since I know exactly what goes in them, how they were tested, etc. That's not to say there aren't other vendors and systems out there that are good. Some are very good, and worth checking into.

I usually scan ads to see what other system vendors in the industry are up to, and alert my readers and subscribers of some of the tricks to be on the lookout for. I'm going to share one of those sneaky tricks in a minute.

This ad caught my eye because it showed tremendous past performance, such as the ability to make hundreds to thousands of dollars per day on 1 or 2 mini S&P contracts. Performance so good that it makes you wonder why the vendor is selling it, but that's another story...

Enticed by the ad, I clicked on through to show hypothetical performance data. In the vendor's mind, once I saw how good the system was at picking trades - how well it picked tops and bottoms - I would undoubtedly be hooked. Unfortunately for them, it had the opposite effect.

Why would hypothetical price charts that showed how well a system picked tops and bottoms work against the vendor? Simple: incorrect backtesting. Please let me explain.

The system in question showed many trades where the system bought at the absolute low of a bar, and sold at the absolute high of another bar. Since there is a bid/ask spread in every futures market, it is normally impossible, or darn near impossible, to get filled on a buy order at the exact lowest price (and the same for selling at the high). You might get filled once in a while at that price, but not consistently.

But when a vendor backtests incorrectly, the system can hypothetically get filled EVERY time at the low (for buys) or at the highs (sells). Those are the results you'll see in the system performance report. In real life, you'd only get filled on the losing trades, but only rarely on the winning trades. So, your results won't be nearly as good as the hypothetical, vendor reported results. In fact, many times correcting for this trick turns a winning system into a real life losing system - it is potentially that bad.

Confused? Well, it is a complicated topic, one most people would not even recognize. But here is what to look for: If hypothetical results show the system can consistently buy the absolute low and sell the absolute high (the extreme points) of a price bar, chances are the system will not work in real time.

The lesson here: make sure you look at any performance history with a skeptical eye. Doing so might save you a ton of money.

SHARP AS A RAZOR

Would you believe that a 14th century priest, and his concepts, can help make you a better trader? Well, English logician and Franciscan friar William of Ockham really can make you a better trader.

Ockham developed the concept commonly referred to as Occam's Razor. Simply put, this principle favors the simple over the complex, when there is a choice to be made, or a path to be followed.

How can this apply to trading? A few different ways.

First, if you are a system trader, perhaps your approach has too many rules, too many parameters, or too much optimizing. While every parameter you add might make your system better historically, the more parameters you have, the less prone the system is to work going forward. Simpler concepts and simple rules tend to be based on fundamental market principles - ones that aren't as likely to change.

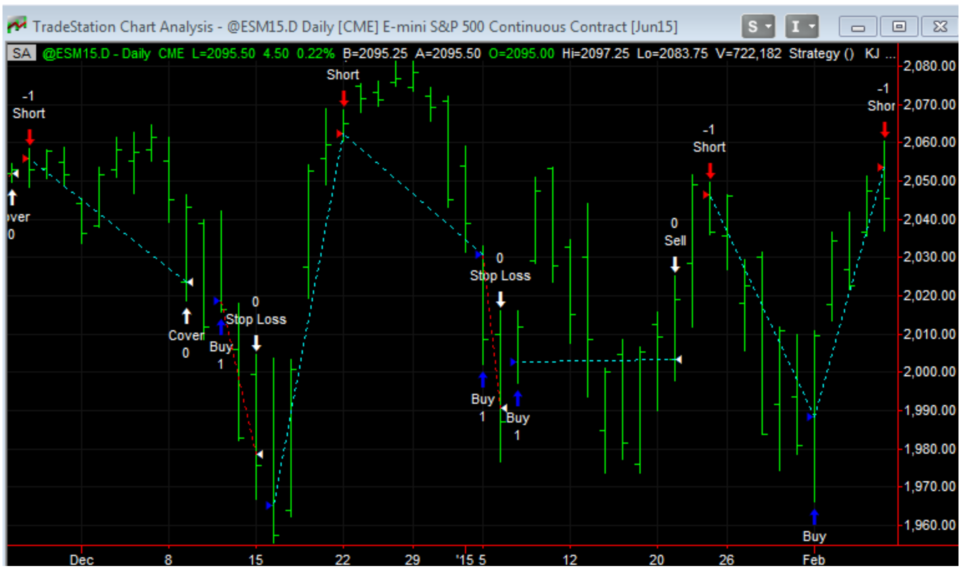
Second, if you are a discretionary trader, you might trade off of news reports from CNBC, Bloomberg and multiple other sources. Multiple news sources might give you more data, but does it really give you more knowledge? You might find that with multiple, conflicting pieces of information, you actually can't trade at all - rather, you are a victim of "analysis paralysis."

Third, maybe your trading office looks like the control room for the Space Shuttle. If you try to trade off all of the information shown on all the screens, you might just find yourself overwhelmed. It is better to stick to a few monitors of information, and know that information very well. The best traders don't need a dozen monitors to trade well - usually 1 or 2 monitors is plenty.

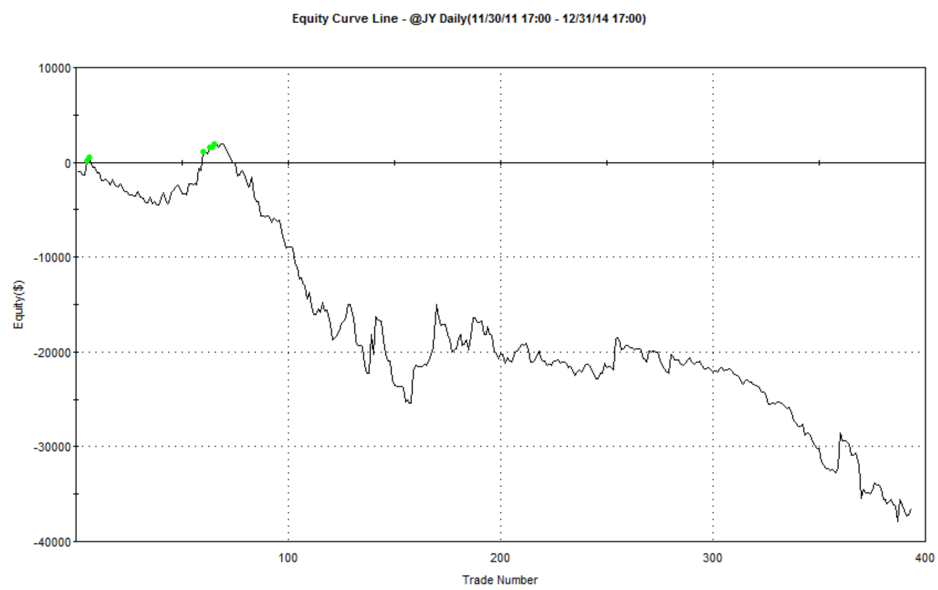
Many new traders tend to think that that more complicated they make trading, the easier it will be to "solve" the markets. Instead, they should be listening to William of Ockham, and making things simpler. Simple, done correctly, can lead to more profits, and stand the test of time better than complicated approaches.

HOW TO CREATE A PROFITABLE TRADING STRATEGY FROM SIMPLE SETUPS

Trading is a funny game. Most people think it is easy, since all you need to start trading is a pulse, and enough money to open an account. With that accomplished, many think the next step is to pull up a chart, find a pattern, and begin trading. If only if was that simple!



Unfortunately, such an approach usually leads to something like this – a brief period of breakeven equity performance, followed by an inevitable downward sloping equity curve.



As a futures trader for 25 years now, I can still painfully remember the time when I used the same approach, and lost 60% of my account in a few short weeks. It was extremely demoralizing, I can tell you that!

After my initial disastrous attempt at trading, I spent a lot of time researching and investigating the top trading methods I could find, and reading interviews with any and all successful traders I could find. After a great deal of searching, I realized one fundamental key:

To succeed in trading, you must have a strategy, and trading setup, that is profitable!

It sounds funny to say that, but most people think trading is all about emotions, psychology, journaling your feelings during trades, etc.

Now, don't get me wrong – without proper emotional control and psychology, you won't get far in trading, even with a profitable system and the best of setups. But, all the mental toughness in the world won't help you make money with a losing strategy!

OK, so just what is a "profitable strategy?" Simply put, it is a set of rules that have been historically proven to make money OVER A LONG PERIOD OF TIME. That last part is key – A LONG PERIOD OF TIME. A strategy that has worked over 1 month or 3 months or 6 months is nice, but it is just not enough time to say a strategy is really good.

If that strategy works over 5-10 years, now we're talking! You want to see the strategy perform well in up markets, down markets, flat markets and volatile markets. The longer the strategy performs, and the more trades it is profitable over, the more likely it is that the strategy will continue to do well in the future.

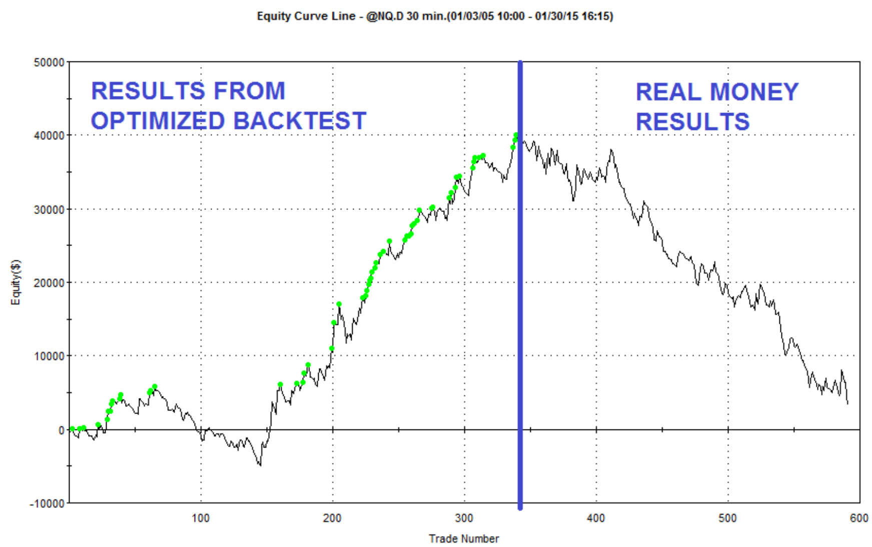
To find out if a strategy, or a setup works, you have to test it. Testing might sound like a daunting task. Fortunately, there is software that can take market data, combine it with your trading setup and rules, and evaluate your strategy's historical performance. I use Tradestation to do this, although there are certainly other good software platforms out there.

So, what are some of my favorite setups? I like simple concepts:

- Breakouts for Trend Following
- Reversal points for Mean Reversion
- 2 Momentum Lengths for Trend Following

If you are interested in some of my setups, I have documented them in a pdf file, and also described them in a webinar I recently hosted. Just click the pictures below to access them.

The key, though, is NOT to take my trading setups, and blindly follow them. **You need to test!** Thankfully, as I mentioned, good testing software is out there. The bad part of testing software is that it is almost TOO easy to evaluate a setup or strategy. Most software encourages you to optimize, which can produce a nice looking equity curve in backtest, but fails in real time:

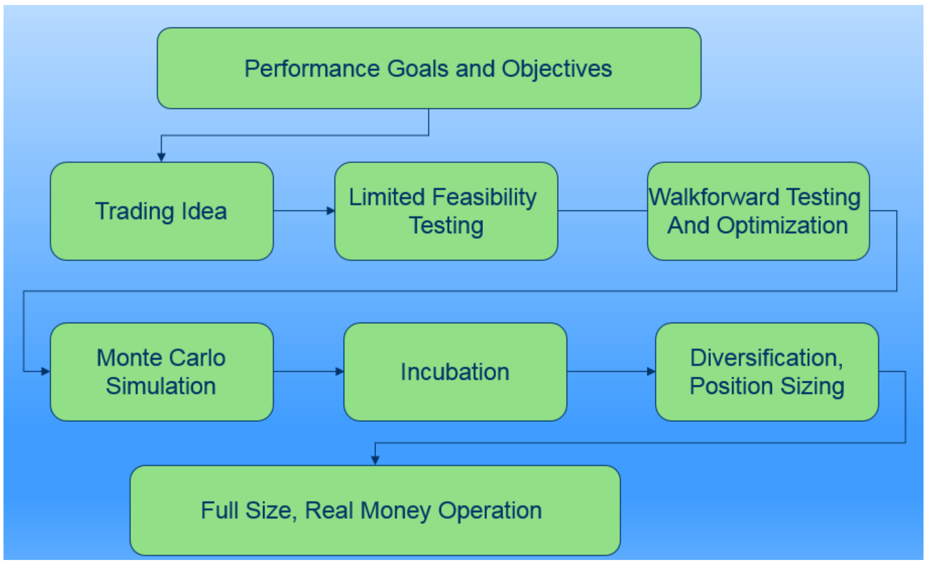


How can a strategy or setup that tested so well work so poorly in real time? Well, what most people don't tell you is that you have to test, BUT you have to test correctly.

Trust me, I know. I used to test incorrectly, and not surprisingly, I got terrible results. But over time, I improved my method of testing and evaluating setups and strategies. I detailed my approach in my best selling trading book, "Building Winning Algorithmic Trading Systems."

My process has been proven to work again and again. I used it to finish in 1st or 2nd place three years in a row in a worldwide, year long, real money trading contest. I used my method to triumph over some of the world's best traders, so it is definitely something to take notice of.

The key to my method is having a defined, step by step plan to develop trading strategies:



Following this process, you too can create long term profitable strategies. It is not easy (if trading was easy, everyone would be doing it!), but it can be done. Here is a short video where I walk you through the development steps for a Soybean futures strategy I have – one I trade with my own money, and based on a simple setup:

You might think developing a profitable strategy is arduous endeavor, and for many people it is. Typically, most people give up too quickly, and go back to haphazard trading with the “hot” chart pattern of the day. I want to offer you a different and better way.

I teach my approach, from A-Z, in a one day online class I call the Strategy Factory Workshop. I teach you my method, how to avoid all the pitfalls along the way, and I even throw in 3 strategies I currently trade - for free! Plus, I follow it all up 6 months of one on one support. I’ll be there to guide you as you create your first truly profitable strategy.

The Strategy Factory Workshop is a great way to learn the RIGHT way to develop trading strategies. With me there to guide you, you’ll be in good hands!

If you are serious about trading strategies, and if you’d read this far I assume you are, my strong recommendation is to learn to create profitable strategies yourself. It is hard work, but in the long run you’ll be better off – you will be able to create trading strategies for any market, tailored to your goals and objectives.

I can help you create strategies just like I create for my own trading. I can assist as you create strategies for stocks, ETFs, futures and forex. Simply sign up for my “Strategy Factory Workshop.”

I follow the workshop up with 4 months of personal support.

If you want to find out more, just go to http://bit.ly/kjtradingtp , or go to my website www.kjtradingsystems.com. When you sign up, just mention this e-book, and I’ll provide 3 extra months of support absolutely free. That is an extra $895 value!

P.S. When I say the workshop is a great value, I mean it. But don’t just take my word for it. Trading Schools.org gives it 5 stars, the only workshop on their website with a perfect score! Hear what this independent 3rd party has to say by tapping here.

ARE BREAKEVEN STOPS WORTH THE EFFORT?

One favorite “gotta have” of many traders is a breakeven stop. By not letting a winning trade become a loser, the psychological lure of breakeven stops is strong. This is especially true for discretionary traders, where the winning percentage can play an important mental (not necessarily financial) role.

The answer for automated traders may be different, though. If breakeven stops hurt performance in the long run, then what use are they? And if they help, are there any key aspects of these stops that improve trading?

This article will provide a framework for evaluation breakeven stops, along with a few examples. Remember though, to evaluate any conclusions with your own research on your own systems.

Click here to continue reading my article at SystemTraderSuccess.com…

GOING LIVE WITH AUTOMATION

Going live with an automated strategy is one of the coolest, but also scariest, things you can do in trading. Here you are, letting a computer trade with your hard earned money. Theoretically, the computer makes ALL the buying and selling decisions, except for rollover trades. Many people simply can't do it – the stress and pressure of trading decisions being made outside of their control is just too much to bear.

The flipside, though, is that automated trading can be extremely liberating. Turning control over to a computer – as long as you trust its decisions – frees you up to do other tasks (likely developing more and more strategies!). Adding automated strategies to a portfolio can be fun and exciting, as well as hopefully ultimately profitable.

Of course, it is assumed that you have a properly tested and vetted strategy ready to go, an example of which is shown in Figure 1. But once you are ready to go, then what? What pitfalls should you look out for? What kind of "tricks of the trade" are available?

Figure 1 – Crude Oil Strategy Walkforward Test Results, Ready to Trade

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FINDING OUT WHAT WORKS, AND WHAT DOESN'T WORK – PART 1

Many traders who try system trading have previously had difficulty at discretionary or manual trading. Most of these folks eventually recognize the benefit of trading a system with well defined rules – a system that has performed well in the past. It is nice to know a trading approach has historically worked, but as with all things related to trading, past performance is no guarantee of future results.

Unfortunately, many people who try systematic/algorithmic/mechanical/rule-based trading for the first time bring along a lot of the baggage that they have acquired from their previous method. Depending on the pre-conceived notions they bring into mechanical trading, these new systematic traders may run into a lot of frustration and trouble.

Many times, for example, traders will always test with a few core concepts, such as always closing by the end of the day. This is what they were used to as a discretionary or manual trader, and therefore they never even think to test ideas out of their old comfort zone. Perhaps removing these "comfort" rules would dramatically improve performance.

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FINDING OUT WHAT WORKS, AND WHAT DOESN'T WORK – PART 2

In Part 1 of this series, found here, I ran a simple study of a trading system, in order to look at some of the common components (such as end of day closes, short versus long bar periods) that many system developers add to their trading system. Could some of these strategy building blocks be hurting their development efforts? To answer the question, I analyzed one trading system over 7 different markets for a 5 year period. Even though I was able to extract some conclusions from the study, I also said the following:

> *"Of course, I made these conclusions based on one study. What if the strategy was different? What if the timeframes or markets were different? What if different years were used for the test period? Will the conclusions reached here still hold? I'll examine those questions in Part 2."*

To summarize the earlier work, the conclusions from Part 1 were:

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THE PERILS OF BUYING TRADING SYSTEMS

Ugh. I've done it again. I bought a "can't miss" trading system I saw on the Internet. What looked so good in the advertisement turned out to look just as bad when I traded it with real money. This seems to happen to me EVERY time I buy a system. Why?

Sound familiar? It certainly should, if you are in the habit of buying trading systems. That is not to say there are not good ones out there – there certainly are. But by and large, purchasing trading systems is an exercise fraught with peril. Here are some reasons why it is so dangerous, and how to protect yourself.

Inherent Dangers in Buying a Trading System

When you buy a trading system based on an advertisement you see in an e-mail, magazine, or website, you typically will see some summary statistics, and a smooth looking equity curve. It probably will look too good to be true (your first warning sign!), but certainly it will look enticing, like the equity curve shown in Figure 1.

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3 WEAPONS TO SLAY THE TRADING WOLVES

The trading world is a tough one. Dog eat dog. Take no prisoners. Those are the facts of this zero sum trading game. And, of course, in such a competitive environment, there are inevitably a lot of sheep and a lot of wolves.

The sheep are typically retail traders, and they are preyed upon by many different types of wolves. High frequency traders are wolves, and more traditional traders at hedge funds and commodity trading advisers (CTAs) are other wolf types. These wolves are your competition, and there is not a lot you can do to eliminate them.

However, there is one brand of wolf you can escape. These are the trading vendor wolves; the proverbial "wolves in sheep's clothing" who claim to be trying to help the sheep with their trading systems and education vending business, but are really lining their own pockets at the sheep's expense.

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5 PITFALLS TO USING A TRADING SIGNAL SERVICE

For many investors, the world of alternative investments, specifically commodities and futures, provides an excellent opportunity for enhanced returns and diversification.

Many, however, are put off by the high management fees (typically 2% of assets per annum) and high profit incentive fees (20% or more of profits) charged by Commodity Trading Advisors and hedge funds. As a consequence, many people look to develop trading systems themselves or use trading signal services.

The do-it-yourself route is popular with investors but unfortunately it is much more difficult than it first appears. While many software platforms make backtesting (testing a strategy using historic data) and optimization easy, only the uninformed would actually utilize a trading system developed in that manner. Developing a trading system the correct way is very involved and should only be attempted by experienced traders.

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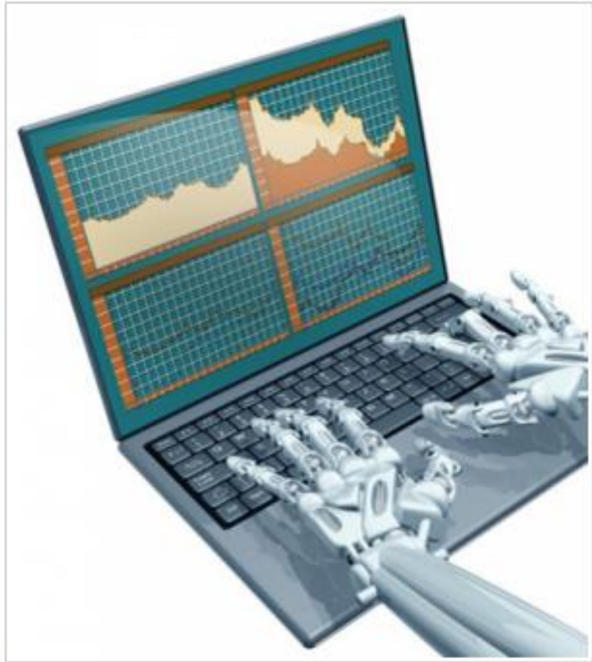
AUTOMATED TRADING – FRIEND OR FOE?



Most people who start trading use a discretionary approach. That is, they make decisions to buy and sell based on things like news, simple chart patterns, and the advice of television talking heads.

Soon after entering a trade, however, the emotions of having real money on the line start to show. The reasons for entering the trade no longer seem as important as the emotions during the trade. Feelings such as hope, fear, greed, stress, and anxiety typically result in bad trading decisions.

Because their emotions get in the way of good trading, many people eschew discretionary trading. They know the disadvantages of trading under duress and therefore look to eliminate all emotions. That leads many people to gravitate towards "emotionless" trading, such as the use of automated programs, algorithmic trading, leasing systems or signals, using a Commodity Trading Advisor, etc.

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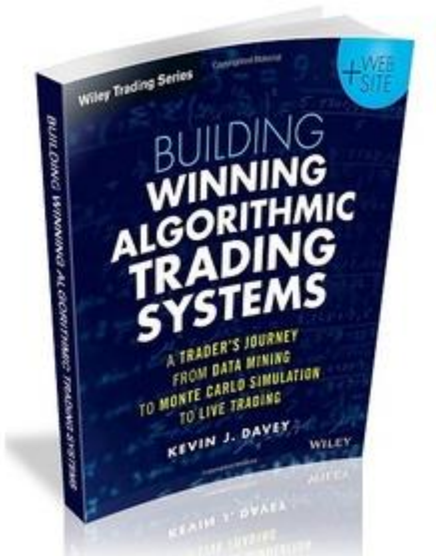
My Algo Trading Book



Hopefully at this point you have idea of what my teaching and writing style is like. If you have enjoyed yourself so far, then I encourage you consider buying my book **"Building Winning Algorithmic Trading Systems – A Trader's Journey From Data Mining To Monte Carlo Simulation To Live Trading."**

My book details not only my personal struggles with trading (you'll enjoy reading about my "mad cow" adventures, and my scale trading debacles), but also my trading triumphs (winning the world's premier futures trading contest, being able to make the leap from part time hobby trader to full time professional trader).

Finally, my book lays out the exact process I use to develop trading strategies. If you follow it, you can build successful strategies too!

I am pretty proud to say that my book won "2014 Trading Book Of The Year," awarded by TraderPlanet.com. That gives you an idea of how good the book is!

Click here to read an excerpt

Click here to read comments from industry experts, and everyday traders just like you

Click here to purchase the book on Amazon.com

Articles – Part 2

FROM CLICHÉ TO STRATEGY

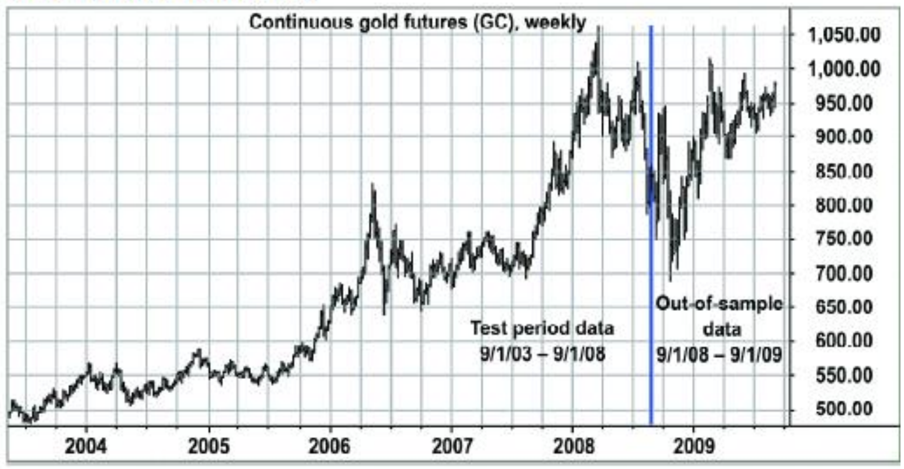
When developing a trading strategy, ignore half-baked advice and start defining rules.

BY KEVIN J. DAVEY

You can't learn to trade by following clichés that lack the specifics necessary to make trading decisions. When was the last time you made easy money by, say, "Letting profits run and cutting losses short?" Great advice, but how exactly do you do it?

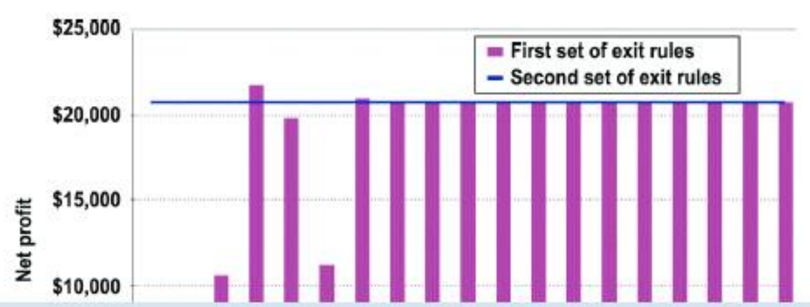
You can learn how markets behave by constructing specific, objective rules for a chart pattern or trade setup and then measuring how price moves afterward. The process can initially seem complex, but it is easier than many people think, especially when you can combine a handful of simple trading concepts.

FIGURE 1: TESTING GOLD FUTURES



The strategy was initially tested and revised on continuous gold futures data from 2004-2008 (in-sample) and 2008-2009 (out-of-sample).
Source: TradeStation

FIGURE 2: TWO PROFITABLE STRATEGIES



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AFTER TESTING, BEFORE TRADING

Monte Carlo simulations provide probabilities for understanding your system's future performance.

BY KEVIN J. DAVEY

Thorough system analysis lays the groundwork for profitable trading, but there's more to the process than producing rigorous "walk-forward" test results. Even after optimizations and out-of-sample tests are complete, it is still too early to begin trading a system with real money. Several questions need to be answered, including: What is the chance of ruin (blowing out a trading account) by trading the system? How likely is a certain percentage drawdown?

"From cliché to strategy" (*Active Trader*,

TABLE 1: CLICHÉ STRATEGY PERFORMANCE (DAILY CONTINUOUS GOLD FUTURES)

Parameter	In-sample (5-yr. period)	Out-of-sample (1-yr. period)	Combined (6 yrs.)
Net profit	$71,410	$28,590	$100,000
Number of trades	162	35	197
Winning %	57%	63%	58%
Profit factor	1.8	1.8	1.8
Avg. trade	$441	$817	$508
Avg. winning trade	$1,680	$2,806	$1,921
Avg. losing trade	($1,230)	($2,549)	($1,474)
Max drawdown	($16,720)	($17,170)	($17,170)
Profit/drawdown	4.3	1.7	5.8

The gold "cliché" system performed well on out-of-sample data, although it did have high drawdowns and a relatively long flat period.
Source: TradeStation

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REFINING CRUDE OIL BREAKOUTS

Various tools are used to understand a crude oil system's behavior and boost its output.

BY KEVIN J. DAVEY

Crude oil is a volatile market — prone to violent price swings and large overnight moves — making it especially challenging for system traders. Starting with a combined trend/countertrend trade setup, we'll use different tools to analyze the system's results and improve performance.

First, let's attempt to create a crude oil (CL) trading strategy that performs well on out-of-sample data. The setup occurs when crude oil's closing price hits its highest high or lowest low over a certain number of bars. When this happens, the system trades in the direction of a trend or against it depending on degree of trend strength or price momentum, as measured by the average directional movement index (ADX). If the indicator is high and/or rising, the market may be trending, which would validate a breakout trade. But if the ADX is low and/or dropping, the market's trend is likely

at next bar's open if:
   a. Current bar's close = *x*-bar highest closing price
   b. 11-bar ADX >= 11-bar ADX[Y]

2. Sell short (and exit longs) at next bar's open if:
   a. Current bar's close = *x*-bar lowest closing price
   b. 11-bar ADX >= 11-bar ADX[Y]

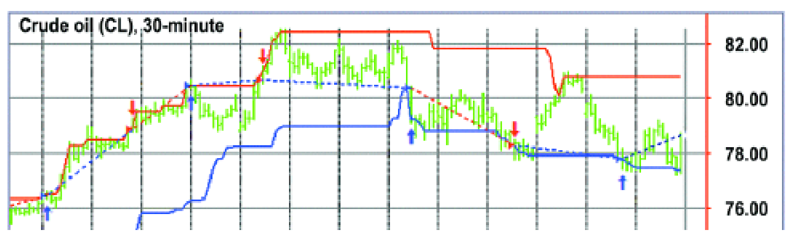
Counter-trend rules:

3. Go long (and exit shorts) at next bar's open if:
   a. Current bar's close = *x*-bar lowest closing price
   b. 11-bar ADX < 11-bar ADX[Y]

4. Sell short (and exit longs) at next bar's open if:
   a. Current bar's close = *x*-bar highest closing price
   b. 11-bar ADX < 11-bar ADX[Y]

where:
x = breakout channel length
y = look-back periods

FIGURE 1: TRADE EXAMPLES



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IMPROVING BOTH ENDS OF A SYSTEM

Before abandoning a sub-par strategy, see what scaling into trades and adjusting exit rules can do for performance.

BY KEVIN J. DAVEY

If you've read any installments of *Active Trader's* ongoing System Design series, you know building a viable trading strategy from scratch is more difficult than it seems. Strategy development is a marathon, not a sprint, but traders are often lured into chasing the latest approaches with the best-looking performance.

Unfortunately, this quest

FIGURE 1: TRADE EXAMPLES

Although the moving-average strategy misfired in early February 2009, it caught two intermediate trends — long in late-December 2008 and short in mid-February 2009.

Source for all figures and tables: TradeStation

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EXITING ON A HIGH NOTE

The first installment of a two-part series tests whether certain some exit signals are better than random.

BY KEVIN DAVEY

Any trader who has suffered a prolonged losing streak has probably thrown up their hands at some point and said, "I'd be more successful if I just randomly entered trades!" This might invoke images of monkeys throwing darts at the newspaper stock listings, but it's not such an absurd idea. Is entering the market at the right time truly as important as everyone thinks?

To find out, the following study examines a trading strategy that enters markets at random times, but exits them using specific rules based on *x*-day highs and lows, moving averages, and the relative

(CL), soybeans, Euro (EC), and E-Mini S&P 500 (ES) — over the past five years.

Choosing different exit points for a strategy affects its performance more than you might expect.

long and short positions and occur only after a random number of days (from one to 10) have passed since the system exited the previous trade. All trades have no directional bias and are independent of the prior trade's direction.

Let's first measure the performance of trades that match random entries with random exits. In the first test, random trades are closed one to 10 days after they are entered, and a random number determines their length. All exits simply close existing positions; they don't stop and reverse direction.

In theory, over a large number of trials a system that combines random entries

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ENTERING ON THE RIGHT FOOT

The second installment of a two-part series compares the performance of different entry signals.

BY KEVIN J. DAVEY

Traders often focus on entering the market at right spot while neglecting exit rules. While it may seem natural to try to enter the market at the optimal moment, "Exiting on a high note" (*Active Trader*, July 2010) contradicted this notion, showing how exit rules contribute just as much to a strategy's success as its entry signals.

That article examined strategies that entered markets randomly but exited according to different technical rules. The best-performing strategy exited trades with a trailing stop based on the 14-day average true range (ATR).

This article tests the opposite scenario: carefully planned entry rules paired with random exit signals. Can a strategy that exits the market randomly still be profitable?

The entry rules use standard technical indicators, including Bollinger Bands, momentum, moving average convergence-divergence (MACD), and the relative strength index (RSI). The analysis will use continuous daily prices four futures contracts — crude oil (CL), soybeans (S), Euro FX (EC), and the E-Mini S&P 500 (ES) — over the past five years.

have passed since the system exited the previous trade. The trades are held a random number of days, from one to 20, with an average of roughly 10 days.

Over many trials a completely random system should have an average trade of zero, excluding commissions and slippage. Its performance is a useful benchmark for comparing other techniques.

Planned entry signals

The next step is to pair five entry signals with random exits that are triggered up to 20 days later.

The first entry signal is based on Bollinger Bands. It enters long if yesterday's high price was above the upper Bollinger Band, but today's high price is below that band; it sells short if yesterday's low price was below the lower band, but today's low price is above that band. Six parameter values were tested: band length (based on 20-, 30-, and 40-day simple moving averages) and the number of standard deviations (one, two, or three). Each version of the system was tested with random exits 500

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DON'T BUILD A BETTER BACKTEST

Ask any experienced system developer about backtests, and you'll likely get an exasperated look. On one hand, he'll say, backtests are great because they can demonstrate if a trading idea has any historical merit. On the other hand, he'll counter, many times backtests tell you little or nothing about future profitability because you are curve fitting or over-fitting a system. Because of this, backtests are both a blessing and a curse.

Those new to trading, however, rarely see the duality in backtests. On the contrary, they see a world of historical profit in optimized tests, parabolic hypothetical equity curves and a sea of dollars just waiting for them in live trading. They expect the historical performance to continue well into the future. A few failed strategies later, though, the trader usually laments why the terrific backtest always fails to emerge in real-money trading.

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BUILDING A TRADING STRATEGY – AFTER TESTING AND OPTIMIZATION

Traders know how hard it is to come up with systems that have a sustainable edge. Many people can look at a chart and determine trading rules that fit a particular chart perfectly. However, when they test their rules over a large period of market history, they learn that their system just doesn't work.

Other traders will develop a system neglecting commissions and slippage. The trading system looks great, and the trader is very enthusiastic—until these real-life frictional costs are added in, and a winning system turns into a breakeven system or worse.

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BUILDING A TRADING STRATEGY INVOLVES MORE THAN TESTING AND OPTIMIZATION

It happens to every trader: the sudden serendipitous rush of a brilliant trading idea. Maybe it occurs on the drive home after a long day at work, or possibly an idea suddenly manifests during a morning shower, and sometimes before falling off to sleep. Wherever it takes place, the normal instinct of the trader is to rush to a computer to test the idea, quickly analyze the results, and if the idea seems successful, begin trading it.

Unfortunately, that is the absolute worst approach to take. Even though trading software (with simple strategy development and optimization features) cuts the time from creating a trading strategy to seeing the historical results to mere minutes, it does not mean it is the right approach. In fact, a quick test and superficial evaluation is usually the completely wrong way.

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TOP 3 MISTAKES OF TRADING SYSTEM DEVELOPMENT

For most traders, strategy development is merely a means to an end—a necessary process to be endured on the path to making profits. Just as spending gold is more enjoyable than panning for it, so it is with trading system development: Actual trading is usually more fun than developing a trading approach.

Unfortunately, this leads traders to take all sorts of shortcuts, and make all kinds of mistakes, as they develop their trading methodology. While this makes the trader's life easier in the short run, mistakes and shortcuts inevitably come back to roost in real-time trading.

The good news is that most traders make the same mistakes in development, and once identified, they can be overcome and corrected. Eliminating these issues won't make strategy development any easier, regretfully. Strategy development, performed the right way, becomes much more difficult when the shortcuts are eliminated.

So, what are some of the most common mistakes and shortcuts? Here are three of the more common ones. We explain why they are harmful, how they can be recognized and how they can be corrected. Avoiding these common mistakes will make any trader a better builder of trading systems.

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AVOIDING TRADING PARALYSIS BY ANALYSIS

Reward vs. risk? You can throw it out on the window. Winning percentage? You can toss that one away, too.

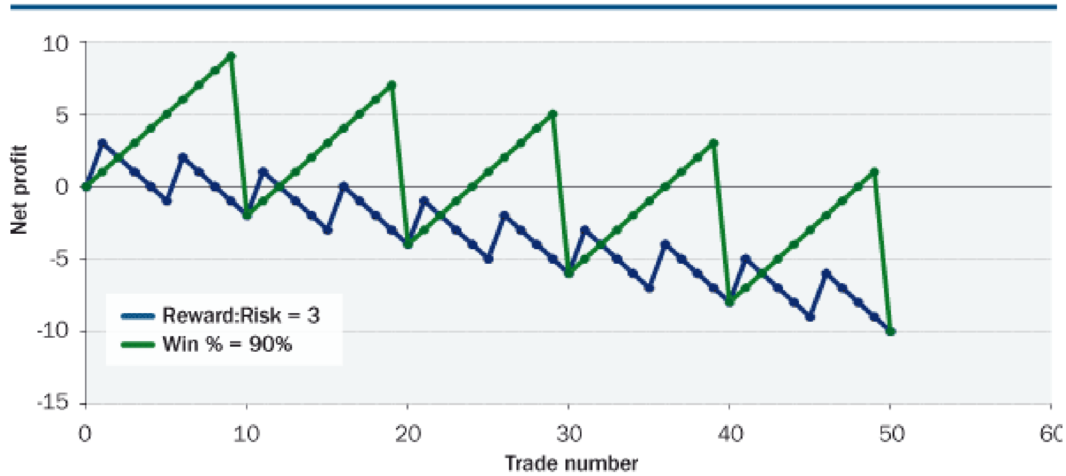
OK. Maybe we're overstating that a bit. However, it is fair to say that what probably are the two most popular trading statistics basically are useless — by themselves. Unfortunately, that exactly is how many people evaluate them. Many traders will jump into a trade with a reward-to-risk ratio of three-to-one, just because they presume this means they will win $3 for every $1 they lose.

Likewise, other traders are drawn to 90% winning percentage strategies like moths to a flame. They must enjoy the frequent sound of the cash register, ringing after each win. No doubt, making money on nine out of every 10 trades does sound pretty good.

In both cases, however, the traders following these approaches are missing a critical piece of the puzzle, and it's a piece that can make a major difference in their bottom lines. "Questionable curves" (below) shows two hypothetical equity curves. The blue curve represents a three-to-one reward-to-risk ratio system. The green curve represents a 90% winning percentage system. Both systems are appealing according to their selected standalone statistics, yet both systems are losers. Why?

QUESTIONABLE CURVES

Even with good statistics, strategies can be losers. Here are two examples.



Source: KJTradingSystems.com

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MYTHS AND FACTS OF EQUITY CURVE TRADING

Most traders have heard the concept of turning a trading strategy on and off — or increasing/decreasing size — when the equity curve rises above or falls below a specified moving average, breaks to a certain new low (or high), or has a specified number of consecutive losing days. The fact is every trader does some sort of equity curve trading, whether they realize it or not. Once a trader makes a decision based on the equity curve, he is in effect equity curve trading.

One specific and popular method of equity curve trading involves the use of an indicator as an overriding switch. A moving average switch on the equity curve is the most popular method. The premise is to trade only when the equity curve is above its moving average. Of course, proponents of this equity curve trading technique typically show glowing examples that “prove” the usefulness of the technique. But, does it really work? How do you set it up and evaluate it?

This two-part series will examine the pros and cons of equity curve trading. In this first part, we’ll establish definitions and some baselines for the analysis. In the second installment, we’ll examine equity curve trading for some real-life trading systems.

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EQUITY CURVE ANALYSIS: A FOOL'S PATH?

Equity curve trading is simply a methodology where a trading strategy is turned on and off based on the gyrations of the equity curve. While there are many different approaches to employing equity curve trading, the concept is straightforward: trade strategies when they are making money, and temporarily turn them off when they are not. If only it were so simple.

With many of the basics of equity curve trading covered in the first installment, this article will look at two different methods of equity curve trading applied to three different real life trading strategies. Reviewing the results may allow some generalizations and conclusions about equity curve trading to be made.
Strategies scrutinized

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AVOIDING DRAWDOWN BREAKDOWNS

When starting to trade a new strategy, many traders wonder, “How will I know if and wher the strategy is broken?” The fear, completely understandable, is that the trader made som sort of mistake during development, and tha without a proper feedback mechanism in place, he will not notice the system is broken until it is too late.

Many traders use a gauge based on historica hypothetical drawdown to determine their quitting point and, unfortunately, many time they end up trading a bad system for too lon Thankfully, there are alternative methods to determine objectively when to stop trading a strategy. This article examines two possible methods and compares them to a standard maximum drawdown approach.

A trading cliché that most of us have heard is, “Your worst drawdown is always in the future.” For most trading strategies, that is absolutely true. Many traders anticipate this, and stop trading when the live trading maximum drawdown exceeds some multiple of the historical maximum drawdown. For example, if a backtest shows a maximum $10,000 drawdown, the trader might decide to stop trading at 150% of this level ($15,000 maximum drawdown), or 200% of the historical value ($20,000).

In either case, the trader succeeds in limiting system losses, hopefully before the account balance is wiped out. That obviously is key. The adage “cut your losers short” applies not only to trades, but also to trading strategies. But before the strategy is stopped, the trader has to endure a painful drawdown. Is there a good alternative, with hopefully a smaller amount of financial pain?

Click here to continue reading my article at futuresmag.com …

DON'T BE A GUNSLINGER

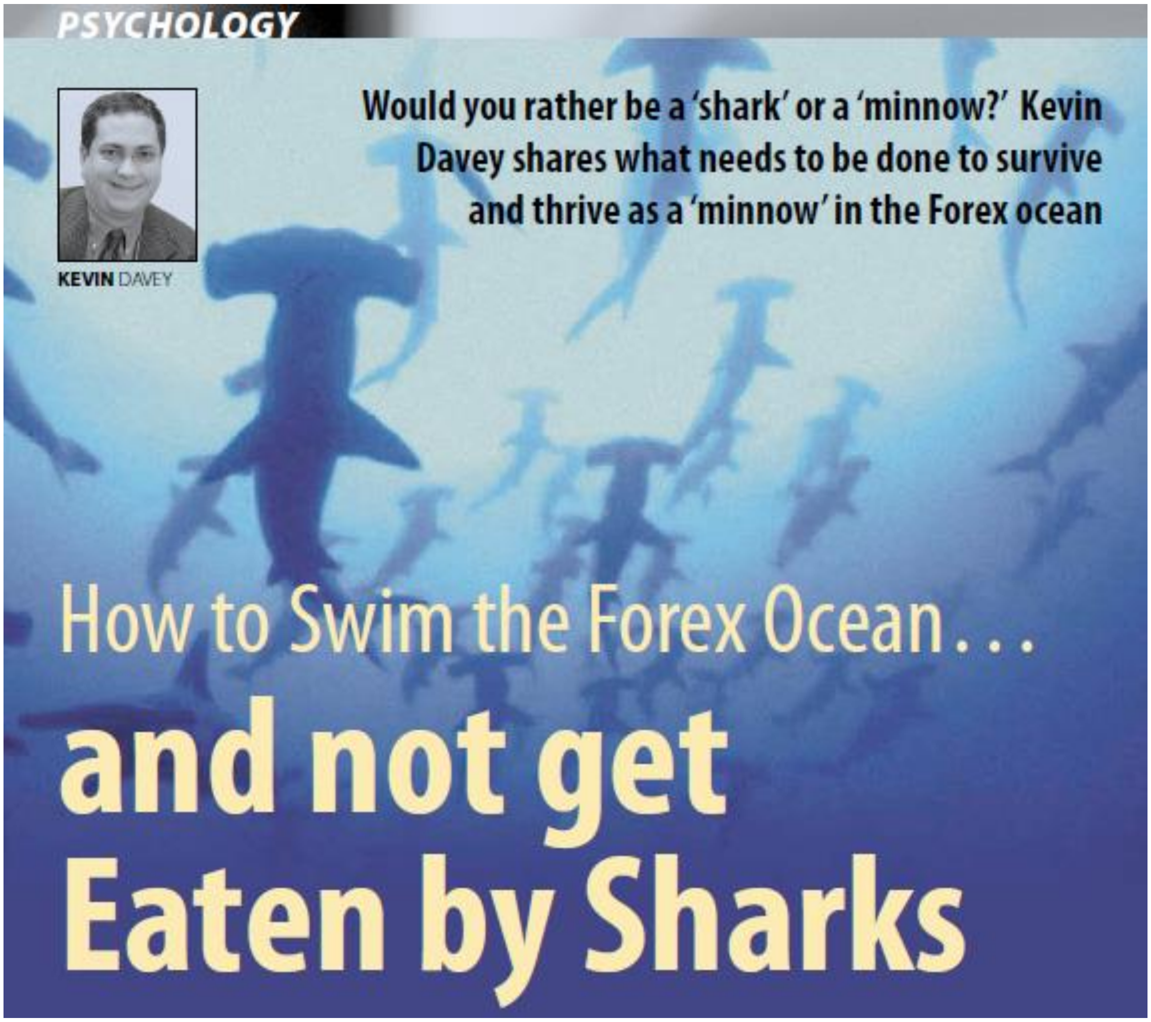
I love shoot 'em up Western movies. I'm sure you know the type of movie I'm talking about: bad guy strolls into town, enters the saloon through the creaky swinging half doors, sees the sheriff sitting at a barstool. Ominous music plays in the background. Bad guy demands that the sheriff step outside. The sheriff obliges, and the two opponents line up twenty yards apart, arms at their side, hands twitching by their gun holsters. They quickly draw their weapons. Both shoot, and one falls to the ground, usually the bad guy.

For most people, this is forex trading.

They see an "opportunity," and jump in the market, shooting wildly. More often than not, they end up dead, out of trading capital.

Click here to continue reading my article …

SWIM WITH THE SHARKS



Click here to continue reading my article …

Presentations

Here are a couple of handout slides for webinars I did. The recordings, unfortunately, were lost to the ether…

CRUSH THE COMPETITION

Click here to continue reading my presentation …

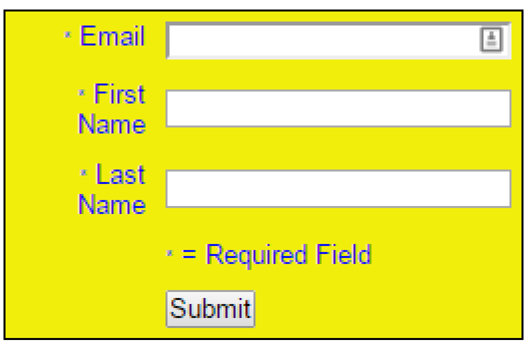
Keep Up To Date With My Work

As you might imagine, I continue to add new articles, videos and webinars to my stockpile of useful and truthful trading information.

You can be assured of getting all the latest information by simply signing up for my e-mail newsletter. I don't spam, and you can unsubscribe whenever you want.

My free webinars are usually overbooked, so being on my list assures you of a chance to sign up before the masses!

Just click on the box below…



Videos

Here are some videos I have done. These consists of webinars, presentations and general information. I think you will like all of these videos! Just click on the screenshot to view the video.

HOW TO TRADE LIKE A CHAMPION (5 PART SERIES)

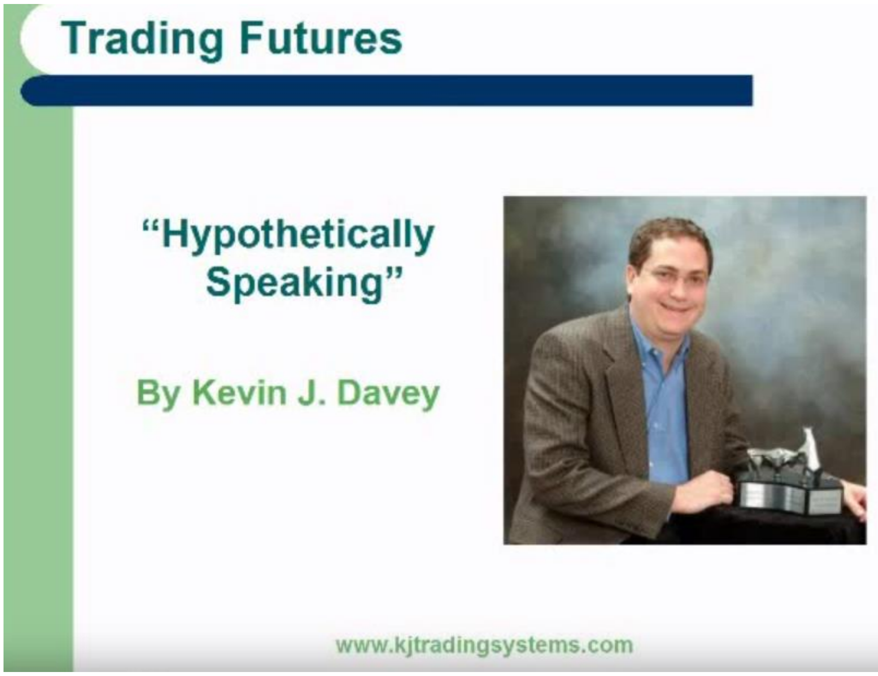
HOW TO PICK A WINNING TRADING SYSTEM (5 PART SERIES)

FORMULATE A TRADING PLAN

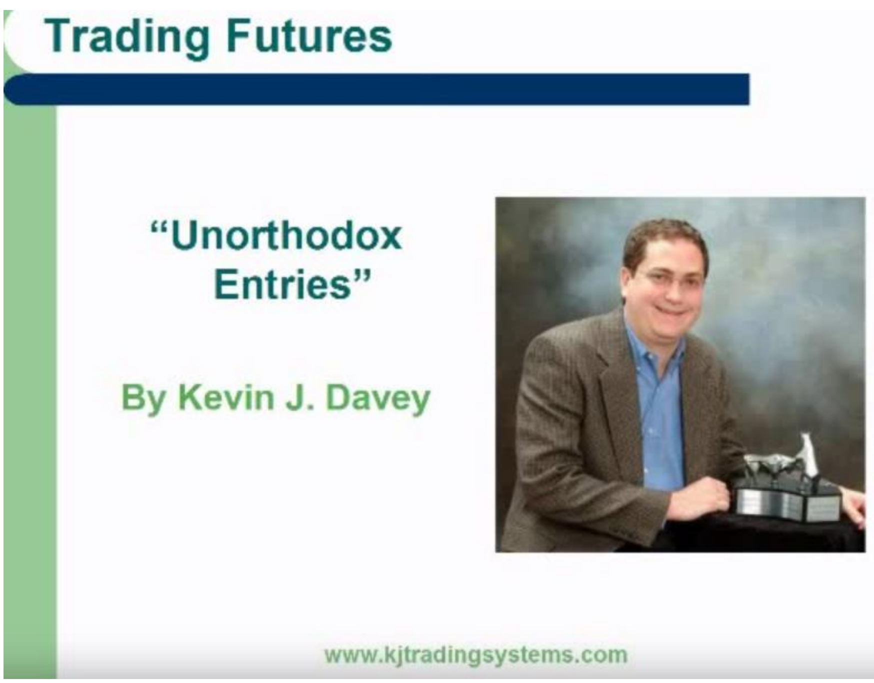
TESTING FOR SUCCESS

7 WAYS TO TRADE THE MINI S&P

HYPOTHETICALLY SPEAKING

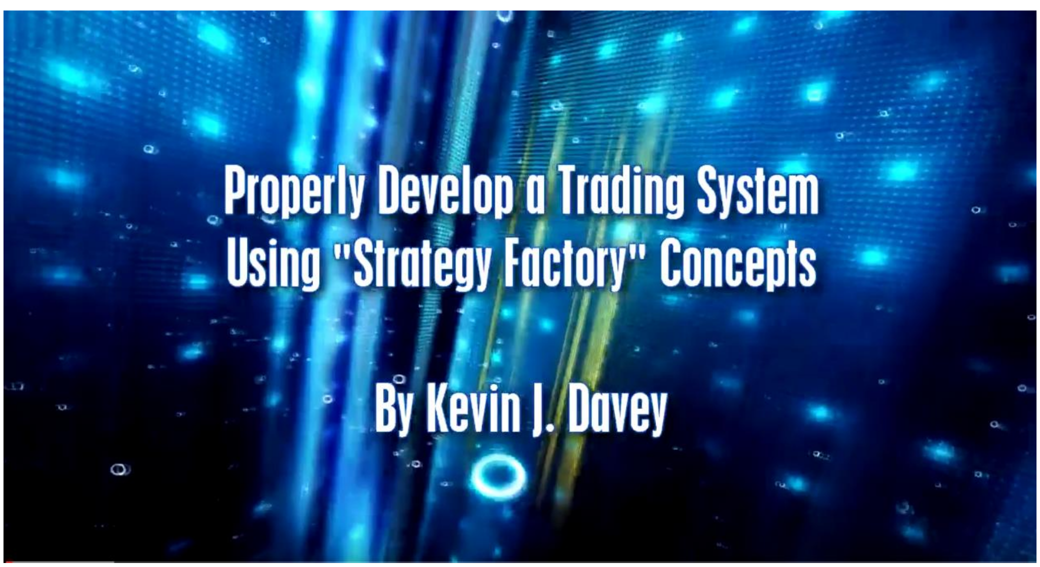


UNORTHODOX TRADING ENTRIES



HOW A STRATEGY FACTORY CAN HELP YOU

DEVELOP A STRATEGY WITH STRATEGY FACTORY PRINCIPLES

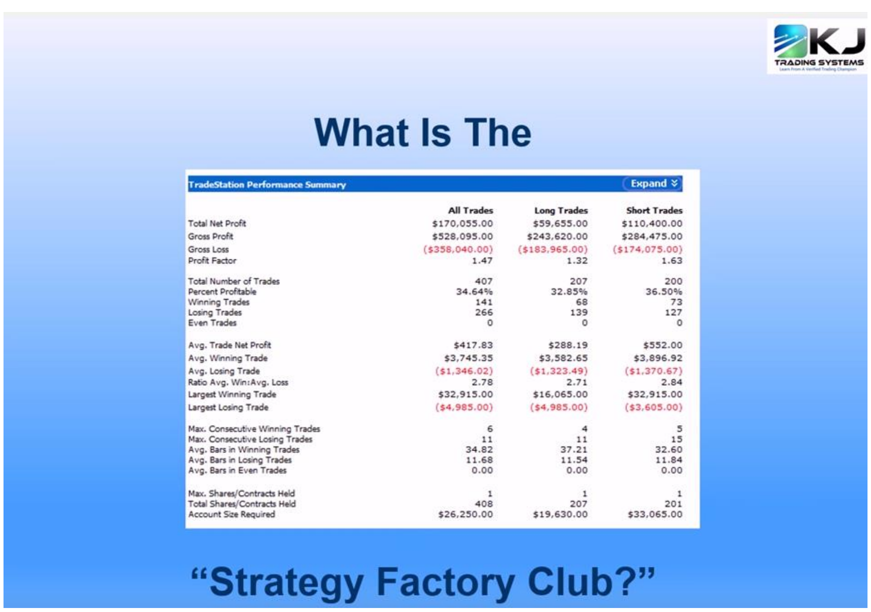


2 MINUTE TRADING TIPS (12 PART SERIES)

POSITION SIZING 101

TRADING GAMES PEOPLE PLAY

WHAT IS THE "STRATEGY FACTORY" CLUB?



TradeStation Performance Summary

	All Trades	Long Trades	Short Trades
Total Net Profit	$170,055.00	$59,655.00	$110,400.00
Gross Profit	$528,095.00	$243,620.00	$284,475.00
Gross Loss	($358,040.00)	($183,965.00)	($174,075.00)
Profit Factor	1.47	1.32	1.63
Total Number of Trades	407	207	200
Percent Profitable	34.64%	32.85%	36.50%
Winning Trades	141	68	73
Losing Trades	266	139	127
Even Trades	0	0	0
Avg. Trade Net Profit	$417.83	$288.19	$552.00
Avg. Winning Trade	$3,745.35	$3,582.65	$3,896.92
Avg. Losing Trade	($1,346.02)	($1,323.49)	($1,370.67)
Ratio Avg. Win:Avg. Loss	2.78	2.71	2.84
Largest Winning Trade	$32,915.00	$16,065.00	$32,915.00
Largest Losing Trade	($4,985.00)	($4,985.00)	($3,605.00)
Max. Consecutive Winning Trades	6	4	5
Max. Consecutive Losing Trades	11	11	15
Avg. Bars in Winning Trades	34.82	37.21	32.60
Avg. Bars in Losing Trades	11.68	11.54	11.84
Avg. Bars in Even Trades	0.00	0.00	0.00
Max. Shares/Contracts Held	1	1	1
Total Shares/Contracts Held	408	207	201
Account Size Required	$26,250.00	$19,630.00	$33,065.00

INTERVIEW WITH A SUCCESSFUL STUDENT

Interviews

BETTERSYSTEMTRADER.COM INTERVIEW

005 – Kevin Davey

00:00 / 00:00

Play in New Window | Download

40 FLARES

Kevin Davey has been developing, analyzing, testing and creating trading strategies for over 25 years, in every futures market from the e-mini S&P to crude oil to corn to cocoa.

He placed in the Top 2 of the World Cup Trading Championships from 2005 – 2007 with the results:

- 2005 – 2nd place with a +148% return,
- 2006 – 1st with a +107% return,
- 2007 – 2nd place with a +112% return.

He now trades full time for his own personal account and coaches small groups of traders to significantly increase their trading results. He's written a book on building algorithmic trading systems and has been featured in a number of other books and magazines.

In our chat he talks about how we went about winning the trading competition, the type of

[Click here to access interview…]()

CHATWITHTRADERS.COM INTERVIEW

EP 038: The development process of an algo trading strategy – from objectives to live trading w/ Kevin Davey

By Aaron Fifield · September 16, 2015 · Podcast · 0 Comments

Chat With Traders
038: The development process of an algo trading strategy - objectives to live trading w/ Kevin Davey

9
SHARES

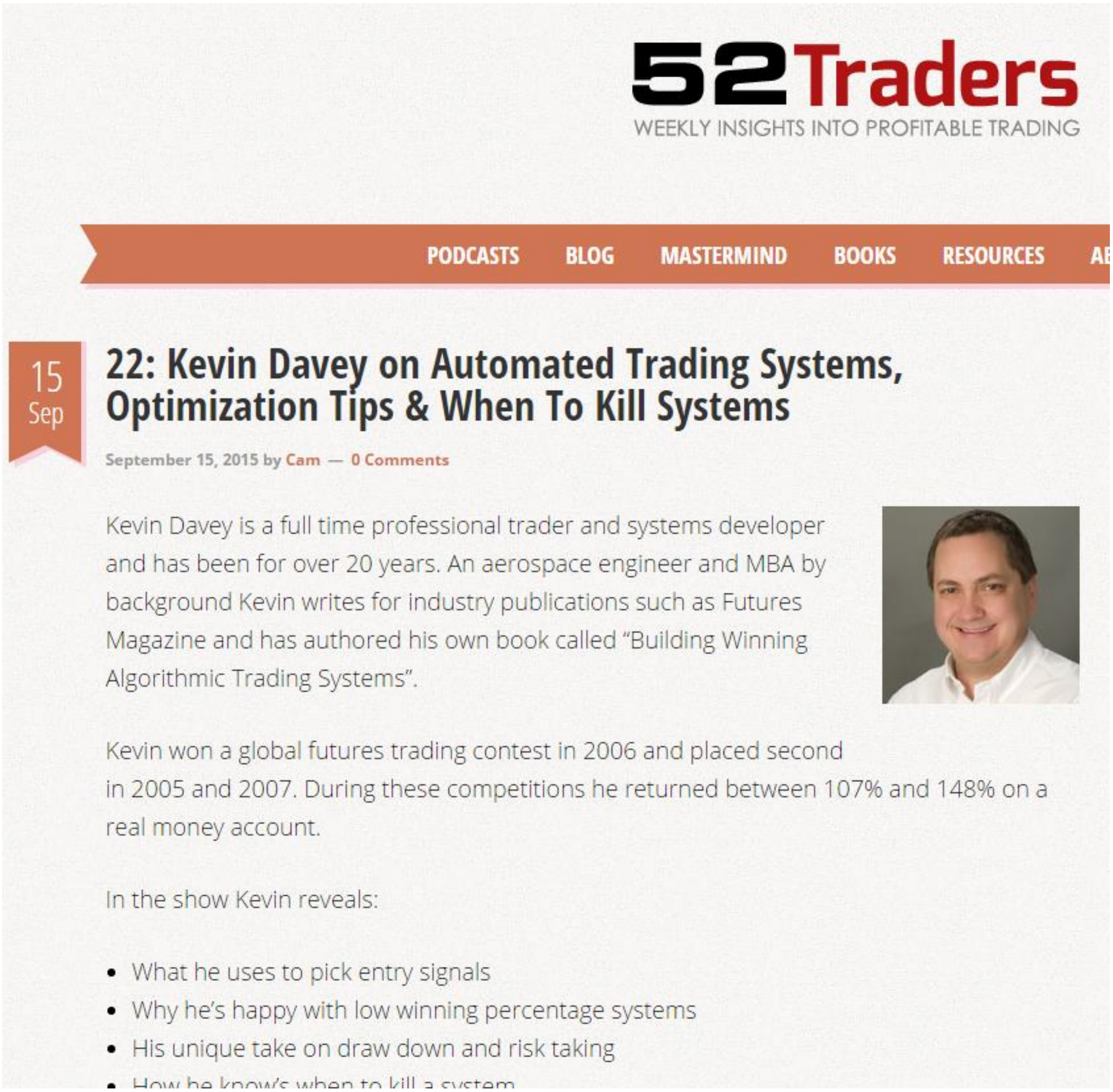
SHARE

TWEET

This week on the podcast I have algorithmic trader, Kevin Davey. Who like many guests in the past, he comes from a background in engineering – there's something about these engineers, they seem to make really great traders…

Click here to access interview…

52TRADERS.COM INTERVIEW



52Traders
WEEKLY INSIGHTS INTO PROFITABLE TRADING

PODCASTS BLOG MASTERMIND BOOKS RESOURCES

15 Sep

22: Kevin Davey on Automated Trading Systems, Optimization Tips & When To Kill Systems

September 15, 2015 by Cam — 0 Comments

Kevin Davey is a full time professional trader and systems developer and has been for over 20 years. An aerospace engineer and MBA by background Kevin writes for industry publications such as Futures Magazine and has authored his own book called “Building Winning Algorithmic Trading Systems”.

Kevin won a global futures trading contest in 2006 and placed second in 2005 and 2007. During these competitions he returned between 107% and 148% on a real money account.

In the show Kevin reveals:

- What he uses to pick entry signals
- Why he’s happy with low winning percentage systems
- His unique take on draw down and risk taking

[Click here to access interview…]

Code Pieces and Snippets

Here are some Tradestation code snippets you can use in your own trading. I use these in my live trading…

CONTINUOUS CONTRACT CHANGE NOTIFIER – PAINT BAR STUDY

```
//this paint bar will color the most recent bar green if there is a difference in the continuous contracts

//DATA1: the continuous contract you are automating/trading:  example  @ESZ15, @CLV15

//DATA2: the continuous contract that is always the front month:  example  @ES, @CL

//so, when the paint bar paints the current bar green from top to bottom on the chart, you will know that the contract has rolled.


If BarStatus( 1 ) = 2 then begin  //check only at close of bar (prevents false signals)


Condition1 = Close[1] of data1 <> Close[1] of data2 ;

Condition2 = Close[2] of data1 <> Close[2] of data2 ;  //see if this makes a difference in false signals

end;


Value1 = GetAppInfo(aiHighestDispValue) ;

Value2 = GetAppInfo(aiLowestDispValue) ;


if Condition1 and Condition2 and LastBaronChart then

        begin

        PlotPaintBar( Value1, Value2,open,close,"plot1",green,value1,5 ) ;

        Alert ;

        end ;
```

POSITION MISMATCH NOTIFIER – PAINT BAR STUDY

```
//THIS WILL PAINT THE BAR RED FROM TOP TO BOTTOM IF THE CURRENT STRATEGY POSITION DOES NOT MATCH THE CURRENT ACCOUNT POSITION

//this is prone to giving false signals, but has never missed a true mismatch

//does not work with forex


Condition1 = I_CurrentContracts*I_Marketposition<>GetPositionQuantity(SymbolName, GetAccountId);



Value1 = GetAppInfo(aiHighestDispValue) ;

Value2 = GetAppInfo(aiLowestDispValue) ;



If LastBarOnChart and condition1 {and (BarStatus( 1 ) = 2 or BarType=2)}  then begin


PlotPaintBar( Value1, Value2,open,close,"plot1",Red,value1,5 ) ;


end;
```

BARSSINCEENTRY EXIT STRATEGY

```
//this will exit after a certain number of bars has elapsed.  Surprisingly good yet simple exit strategy
Input: bse(5);

If barssinceentry>=bse then begin
 Sell next bar at market;
 Buytocover next bar at market;
End;
```

SIMPLE MOMENTUM ENTRY

```
//this is an incredibly simple, yet effective, method of entry.  Add it to your favorite filters, etc and test it out!
Input: mome(5);

If close>close[mome] then buy next bar at market;

If close<close[mome] then sellshort next bar at market;
```

Putting It All Together

If you've made it this far, you might be thinking "all this information is great, but how do I put it all together and create trading strategies"?

Here is a link to a webpage where I do just that – put everything together to create a Soybean trading strategy.

http://www.kjtradingsystems.com/freesys.html

My Strategy Factory Workshop

As we get to the end of this document, I hope you have a sense of the kind of trader I am, and the kind of trading educator I am. I am constantly told “you aren’t like other trading vendors” – and that is a great thing! Most vendors don’t even trade! Most are great at sales and marketing, but awful at actually trading. I am the exact opposite – in fact I probably turn away more people for my workshop (“you just aren’t ready yet” “this workshops doesn’t fit your trading style” etc.) than I accept.

But that is OK – I’d rather be a good trader and a bad salesperson, rather than the other way around!

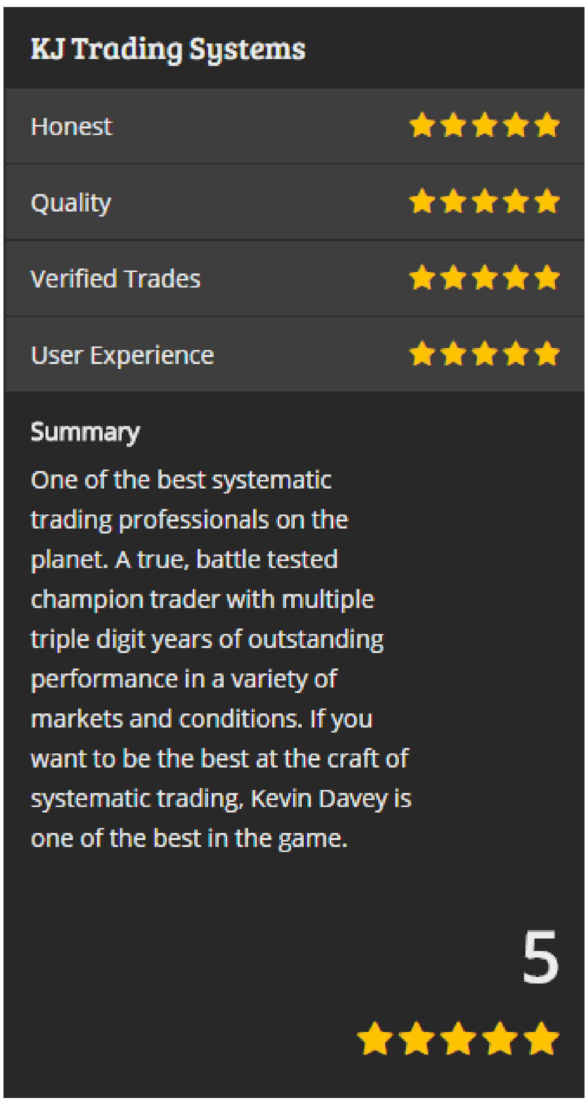
If you liked the information in this package, chances are you will really like and benefit from my Strategy Factory Workshop. You can read all about it right here:

http://www.kjtradingsystems.com/strategy-workshop.html

But, I can tell you all day long how great my Strategy Factory Workshop is, but it doesn’t mean as much as what 3rd parties say, and what students actually produce.

3RD PARTY REVIEWS OF THE STRATEGY FACTORY WORKSHOP

Here is a 3rd party review of my course. Take a look at my overall score 5/5, compared to most of the others out there. My workshop stands head and shoulders above the pack:



Read the full review here: http://www.tradingschools.org/reviews/kj-trading-systems/

Two years after that first review, the same website decided to conduct another review of my work. Same top marks, even though the reviewer calls me a "little rat!"

KJ Trading Systems

Honesty	★★★★★
Quality	★★★★★
Cost	★★★★★
Support	★★★★★
Verified Trades	★★★★★
User Experience	★★★★★

5.0

★★★★★

Summary

TradingSchools.Org originally reviewed Kevin Davey of KJ Trading Systems back in January 2015. He received an excellent review. Its been two years and many individuals have requested an update. Not much has changed.

In fact, Kevin Davey continues to produce stellar trading results. 100% verifiable. 100% transparent.

If you have ever wanted to take a sneak peak at the inner working of a professional retail trader, that consistently earns an enviable income, this is your chance.

And Kevin's book remains an indisputable classic for every aspiring trader.

Here are some reviews from TraderPlanet.com, a great website for trading information…

TRADER PLANET

2016 STAR Awards Review *published December 14, 2016*

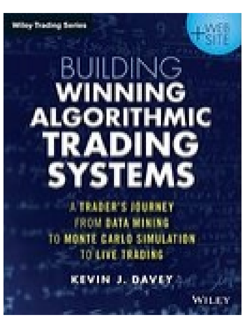
The common image of the algorithmic trader is an extremely well-capitalized quant with premium grade trading technology and lightning fast data access.

Yes, those algorithmic traders exist but there's also individual traders without the huge technological assist or massive accounts using their methodology to be successful.

Kevin J. Davey is the champion of the smaller trader looking to compete with the big boys by using their systematic approach. Davey has been developing, analyzing, testing and creating trading strategies for over 25 years, in every futures market from the e-mini S&P to crude oil to corn to cocoa. Unlike most trading educators, he has verifiable proof of his trading acumen having won the World Cup Championship of Futures Trading.

TRADER PLANET

2016 STAR Awards Review *published December 13, 2016*



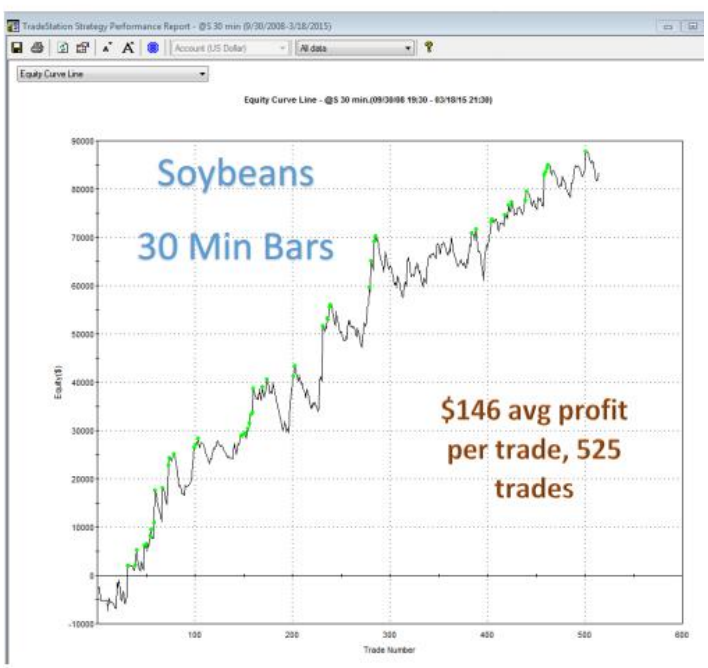
The titles beckon you to buy…" *Make a Million Dollars Day Trading by Tomorrow"* or *"Turn on your Computer and Watch it Print Money."* While these may be a bit hyperbolic, any investor who has spent time perusing the shelves or online libraries looking for trading education knows there are a bevy of books promising get rich quick strategies and no fail promises.

Of course, these dime a dozen books will inevitably end up costing you more than a few dollars if you follow their unfounded and often unscrupulous trading advice.

Kevin J. Davey's book *"Building Winning Algorithmic Trading Systems - A Trader's Journey from Data Mining to Monte Carlo Simulation to Live Trading"* is truly different.

STUDENT CREATED STRATEGIES

But even better than that is what students have accomplished with the Strategy Factory. Here are some of their walkforward (out of sample) performance curves, for strategies they developed using my Strategy Factory principles. I am really proud of their results! With some hard work, you can create strategies just like they have!



http://www.kjtradingsystems.com/StudentStrategies.pdf

STRATEGY FACTORY WORKSHOP – SPECIAL OFFER

When you sign up for the Strategy Factory workshop, simply send me an e-mail telling me you'd like the "Algo Trader's Toolkit" and I'll credit you with an extra 3 months of free one on one e-mail support – a $895 value! I'll be "by your side" as you develop your trading strategies!

http://www.kjtradingsystems.com/strategy-workshop.html

If you have any questions, or just want to talk trading, feel free to e-mail me at kdavey@kjtradingsystems.com

Thanks for reading, and I hope you've enjoyed your "Algo Trader's Toolkit"

Final Reminder- Join My List, Stay Up To Date!

As you might imagine, I continue to add new articles, videos and webinars to my stockpile of useful and truthful trading information.

You can be assured of getting all the latest information by simply signing up for my e-mail newsletter. I don't spam, and you can unsubscribe whenever you want.

My free webinars are usually overbooked, so being on my list assures you of a chance to sign up before the masses!

Just click on the box below…