**Australian Technical Analysts Association**

# Times are Changing

**Part 4 : Exit Strategies**

Do we need to change our exit strategies to suit the different market dynamics?

Will the old moving average cross system work or do we need something that is more aggressive but also more selective?

**By Neil Wrightson**

# Times are Changing – Exit Strategies

As always, this presentation is about my beliefs in trading the markets.

This should be used as educational material only and no attempt should be made to trade using any method without personally testing the method.

This talk will be based on using Long positions only.

Short positions loosely follow the same rules as long trades but are completely turned up side down.

# Times are Changing – Exit Strategies

## Review

Remembering from my previous presentations, the Exit Strategy is only one component of a Trading System and the Trading System is a component of our Business Trading Plan.

The Trading System comprises the following components

- System Type – (Scalp, Swing, Trend)
- Money Management - Maximum Risk for this Instrument and system type etc
- Expected trade duration (number of bars)
- Time frame i.e. 5 Min bars
- Entry Strategy
- Exit Strategy
- System Monitoring & Evaluation

# Times are Changing – Exit Strategies

To establish some fluency in these presentations, I will use the same Entry Strategy as used in the previous presentation on "Entry Strategy Testing" and over the same period.
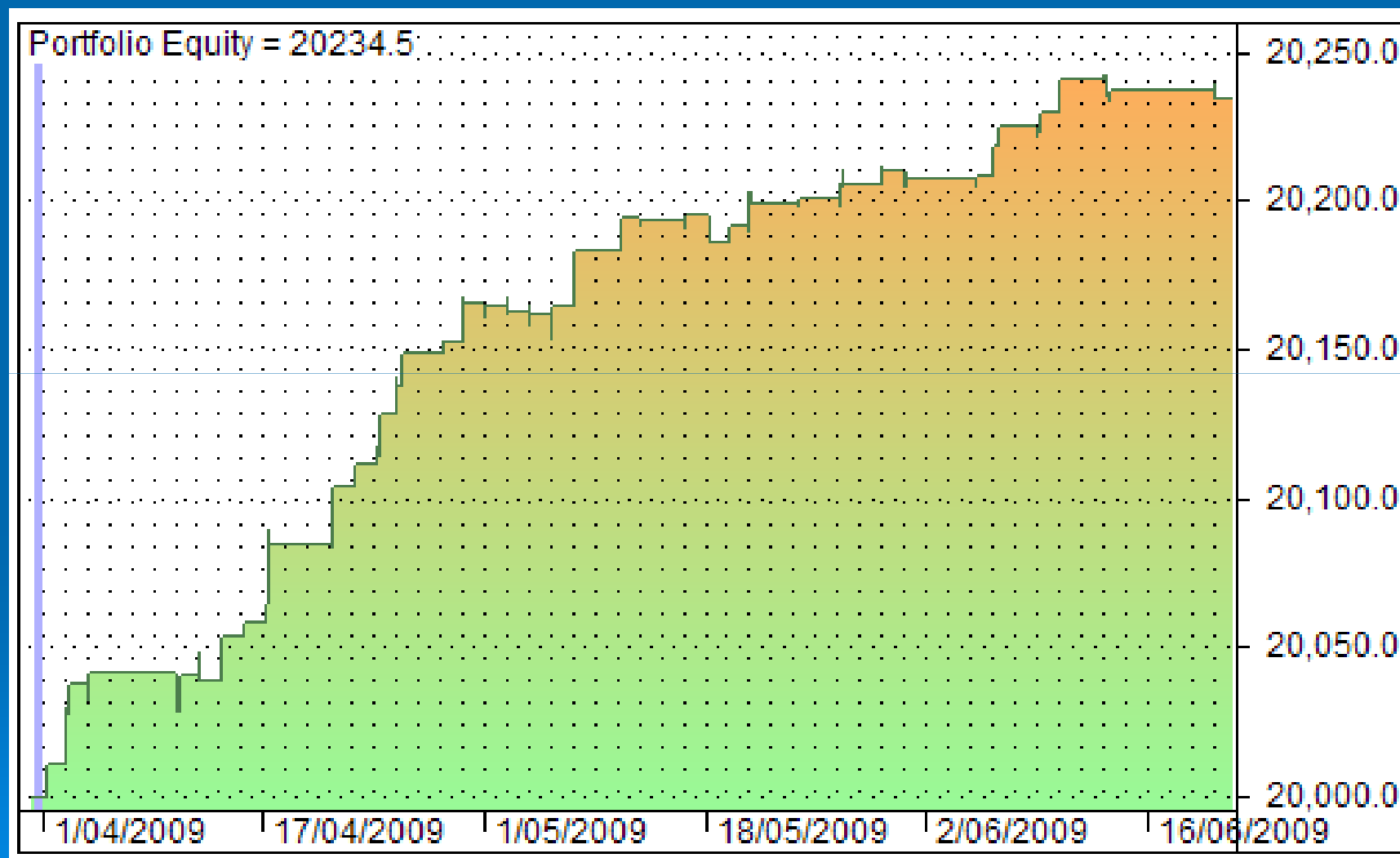
This strategy was looking for 10..20 point moves in a market that was in the 4000 region.

Expected trade duration was in the 5..10 bar range.

Again it was only testing Long Positions.

# Entry Strategy back testing results
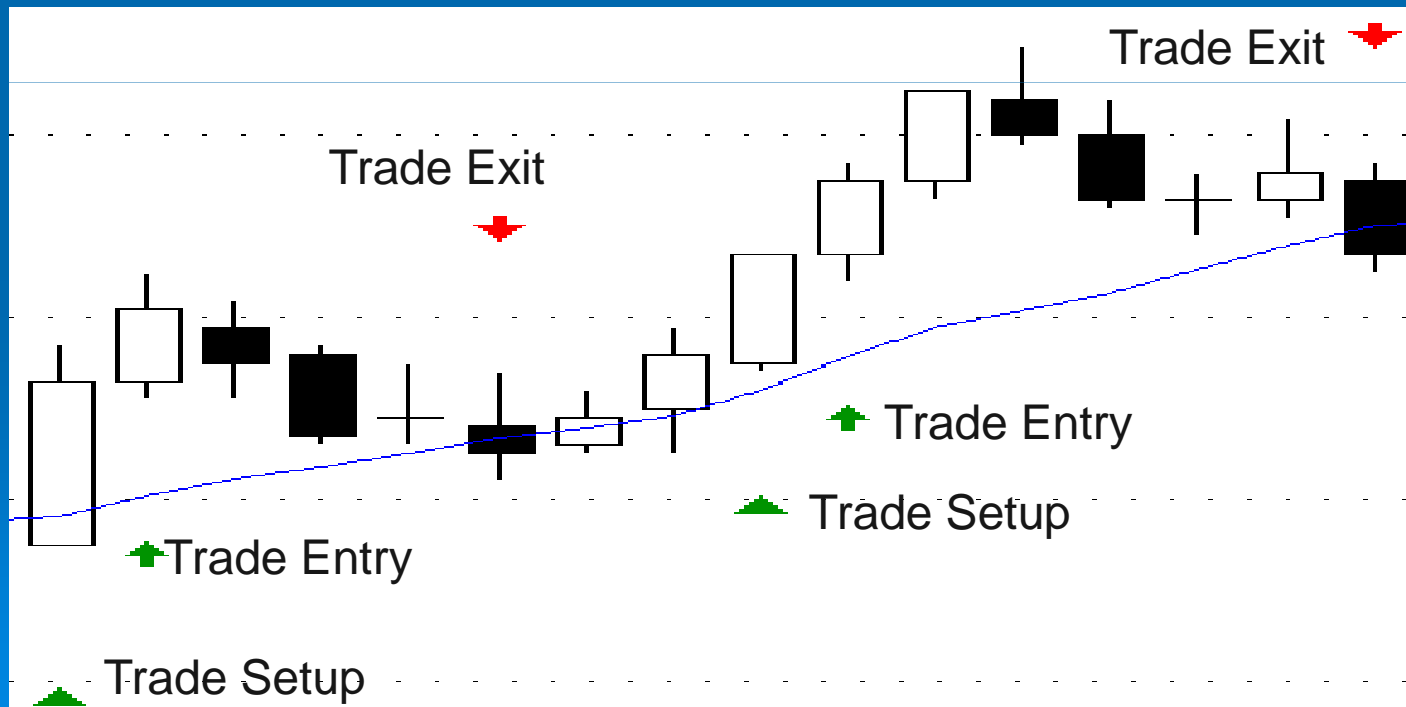## Without a specific Exit Strategy

# Times are Changing – Exit Strategies

This example shows two typical trades using our entry strategy.

The Basic Exit Strategy consists of

1. Exit if price goes below 10 Point Initial Stop.
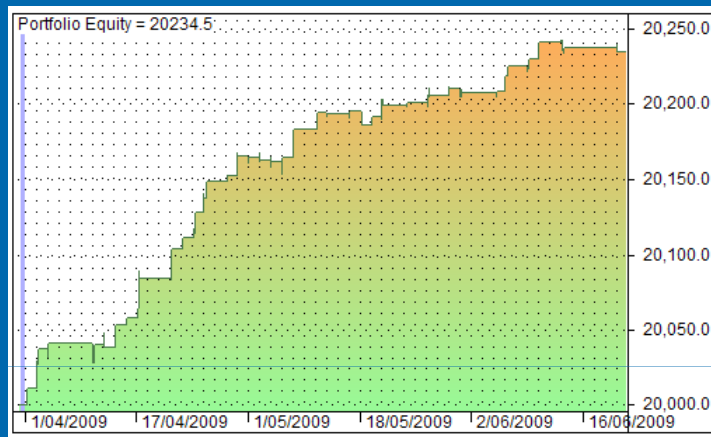2. Exit if Close below 10 period SMA.

The 10 period SMA was chosen because it reflects the length of trade we are targeting.
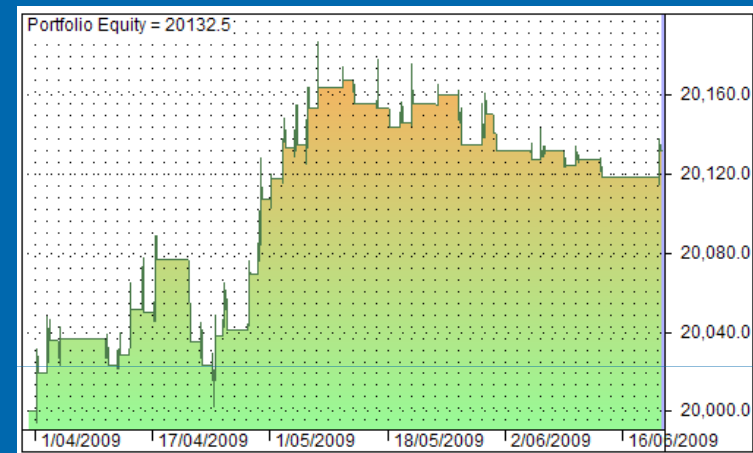
# Times are Changing – Exit Strategies

Now the Profit return and equity curve of the trade using this Basic Exit

Original Entry Test Results                                   Basic Exit Results



## How to ruin a good Entry Strategy in one move

These two charts graphically show the effects of a poor exit strategy on a good entry strategy.

If prior testing of the entry strategy had not already confirmed that it was a winner, then the entry would probably be scrapped and a new trading system formulated.

# Times are Changing – Exit Strategies

## Why do we need an Exit Strategy?

Capital Accumulation

Capital Utilisation

Capital Preservation

# Times are Changing – Exit Strategies

# Why do we need an Exit Strategy?

## Capital Accumulation

Apart from the obvious of making money, it is also about banking the money. I.e. don't let a profitable trade turn into a loser.

## Capital Utilisation

Capital utilisation - Moves us out of trades that are not making money so that it may be better utilised.

## Capital Preservation

Capital Preservation - Is about adhering to our maximum risk value and also about moving into a breakeven / profitable position as soon as possible.

# Times are Changing – Exit Strategies

## Stages of an Exit

1. Money Stop

2. Initial Strategy Exit

3. Stall / Consolidation Exit

4. Break Even Level

5. Profit Accumulation Exit

6. Time of Day Exit

# Times are Changing – Exit Strategies

## Stages of an Exit

### 1. Money Stop

This is the maximum amount that you are prepared to loose per trade, using this trading system.

Personally, this is the location "I" put a physical stop in the market. This is to protect against extreme situations. I.e. power failure mid trade.

This is NOT the typical price I would exit if the trade goes against me.

# Times are Changing – Exit Strategies

## Stages of an Exit

### 2. Initial Strategy Exit

This is the usual exit point for a trade that has gone wrong straight away. This is normally a level set by a technical perspective i.e. lowest low of the entry bar or lowest low of the past three bars.

This is normally referred to as the Initial Stop (I.S.)

**Note.**

This is one of two possible exits for a trade that has failed.

# Times are Changing – Exit Strategies

## Stages of an Exit

### 3. Stall / Consolidation Exit

This stage comes into play when the price action is an under achiever and has not reached our breakeven stage. Basically the entry is a failure.

This can be handled in two ways.

a) After n bars exit the trade regardless of price movement if not in profit.

b) Wait n bars for the Entry Strategy to work and then place a progressive stop under the low of each new bar. This will make the best of a stall situation.

# Times are Changing – Exit Strategies

## Stages of an Exit

### 4. Break Even Stage

This stage is used to get into a risk free position as soon as possible.

There are usually one or two internal stages.

One Stage –

When the price reaches a risk to reward (R/R) level of 1 i.e. the price is at our entry price plus our initial risk value.

Adjust stop to entry price (Break Even / Free Trade).

Two Stages –

(1) When the price reaches the entry plus ½ initial R/R, adjust the exit stop from Initial Stop (I.S.) to I.S. + ½ initial R/R.
(2) When the price reaches the entry + 1 * Initial R/R, adjust the stop to the entry price. (Break Even / Free Trade).

# Times are Changing – Exit Strategies

## Stages of an Exit

### 5. Profit Accumulation / Retention

The Profit Retention Stage should take control of the trade from the entry strategy. A good place to do this is after the Break Even Stage. This stage largely comes down to personal preference but it must suit the intended trading system.

Examples of these are

- Moving Average (Close below MA)
- Moving Average  Cross (Fast crosses a slow MA)
- Parabolic SAR
- MACD
- Trailing Stop

# Times are Changing – Exit Strategies

## Stages of an Exit

### 6. Time Exit or EOD Exit

This stage is used to exit from the trade at a specific time i.e. the End Of the Day (EOD).

Most brokers will be able to handle this style of exit order as well as some online trading systems.

This order is placed and filled regardless of wether the trade is in a winning or losing position. When performing intraday trading, this allows us to sleep at night knowing that we have no open positions going against us.

# Times are Changing – Exit Strategies

To demonstrate the effectiveness of these stages, I have created three different Exit tests.

### 1. Basic Exit Test - Criteria

1. Maximum 10 Point Initial Stop
2. Close below 10SMA

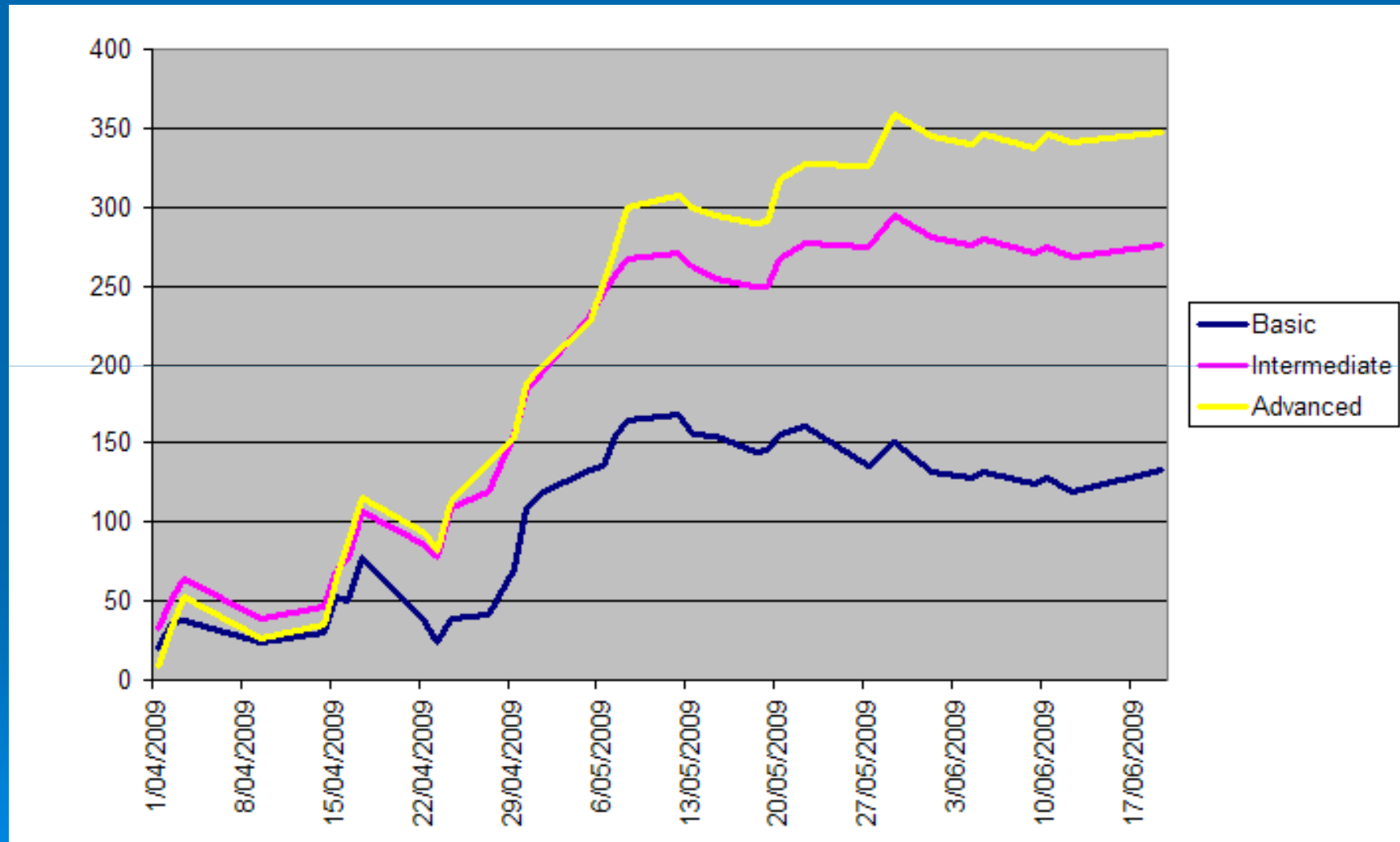### 2. Intermediate Exit Test - Criteria

1. Maximum 10 Point Initial Stop
2. Close below 10SMA
3. Incorporate 5 Bar Stall Exit
4. Incorporate Two Stage Breakeven

### 3. Advanced Exit Test – Criteria

Same as Intermediate but also add Trailing Stop with 1 * ATR(5)

# Times are Changing – Exit Strategies
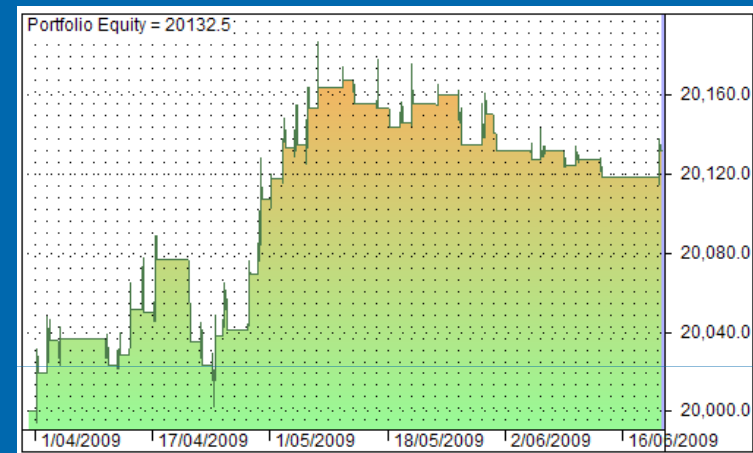## Test Comparison results of utilisation of Exit Stages

# Times are Changing – Exit Strategies

Now the Profit return and equity curve of the trade using this Basic Exit

Original Entry Test Results
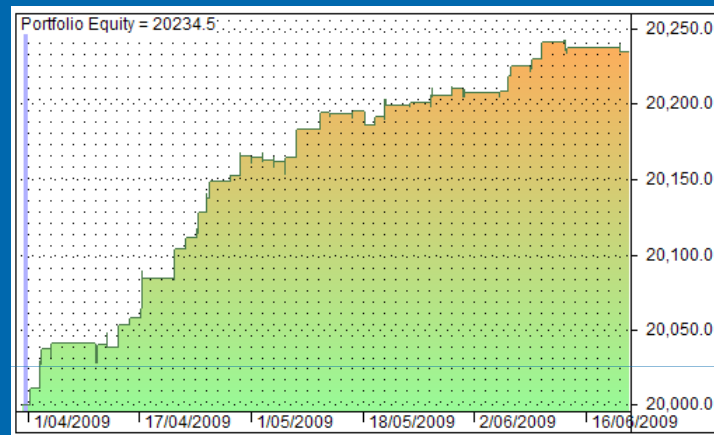
Basic Exit Results





**Bench Mark Results**
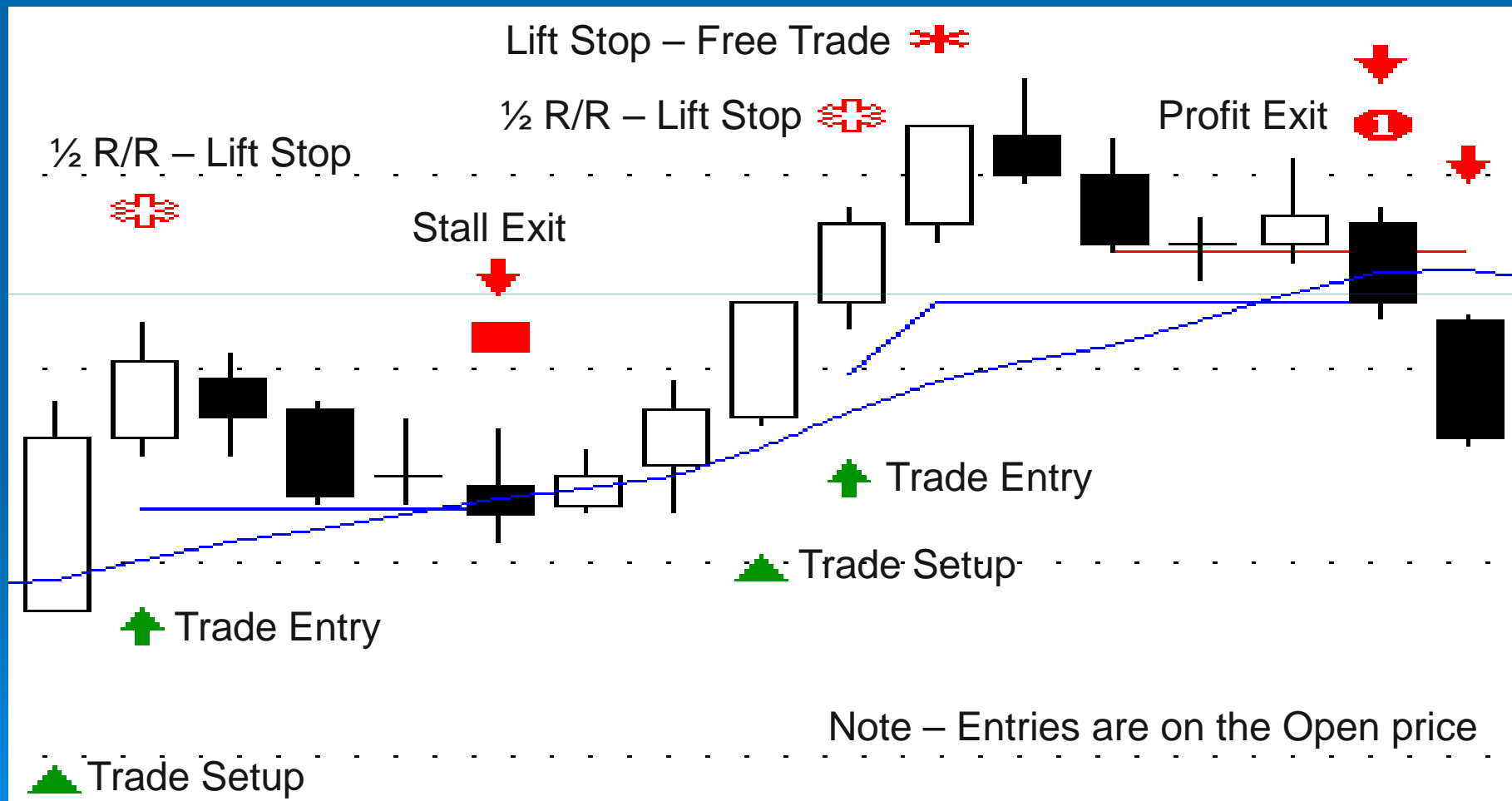
| | |
|---|---|
| Number of trades | 47 |
| Winners | 72% |
| Losers | 28% |
| Net Profit | 234.5 |
| Avg. Profit/Loss (Expectancy) | 4.99 |
| Avg. Profit | 8.498 |
| Avg. Bars Held | 3.00 |
| Largest win | 19.50 |

**System test results**

| | |
|---|---|
| Number of trades | 102 |
| Winners | 40% |
| Losers | 60% |
| Net Profit | 132.5 |
| Avg. Profit/Loss (Expectancy) | 1.3 |
| Avg. Profit | 11.67 |
| Avg. Bars Held | 10.95 |
| Largest win | 36 |

# Times are Changing – Exit Strategies

This example shows two typical trades using our entry strategy.

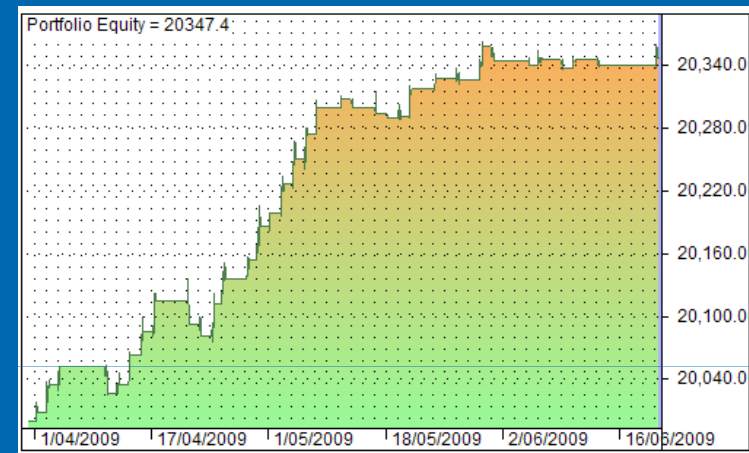The Exit Strategy consists of the full compliment of exit stages.

Lift Stop – Free Trade

½ R/R – Lift Stop

½ R/R – Lift Stop

Profit Exit

Stall Exit

Trade Entry

Trade Setup

Trade Entry

Note – Entries are on the Open price

Trade Setup

# Times are Changing – Exit Strategies

Now the Profit return and equity curve of the trade using the Advanced Exit
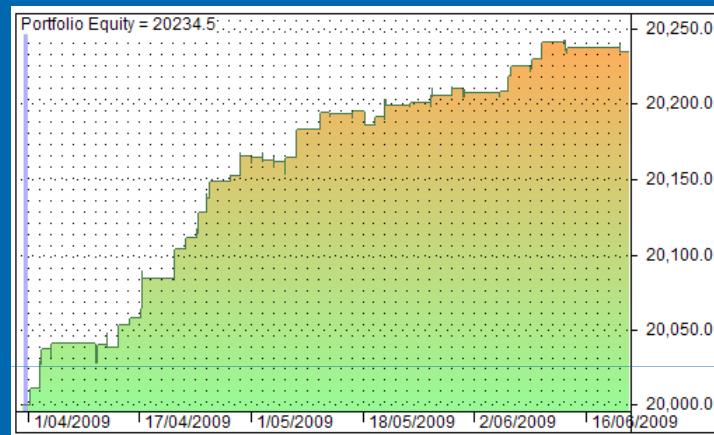
| Original | Advanced Exit |
| --- | --- |



**Bench Mark Results**

| | |
| --- | --- |
| Number of trades | 47 |
| Winners | 72% |
| Losers | 28% |
| Net Profit | 234.5 |
| Avg. Profit/Loss (Expectancy) | 4.99 |
| Avg. Profit | 8.498 |
| Avg. Bars Held | 3.00 |
| Largest win | 19.50 |

**System test results**

| | |
| --- | --- |
| Number of trades | 99 |
| Winners | 49.9% |
| Losers | 50.1% |
| Net Profit | 347 |
| Avg. Profit/Loss (Expectancy) | 3.51 |
| Avg. Profit | 12.74 |
| Avg. Bars Held | 9.12 |
| Largest win | 35.87 |

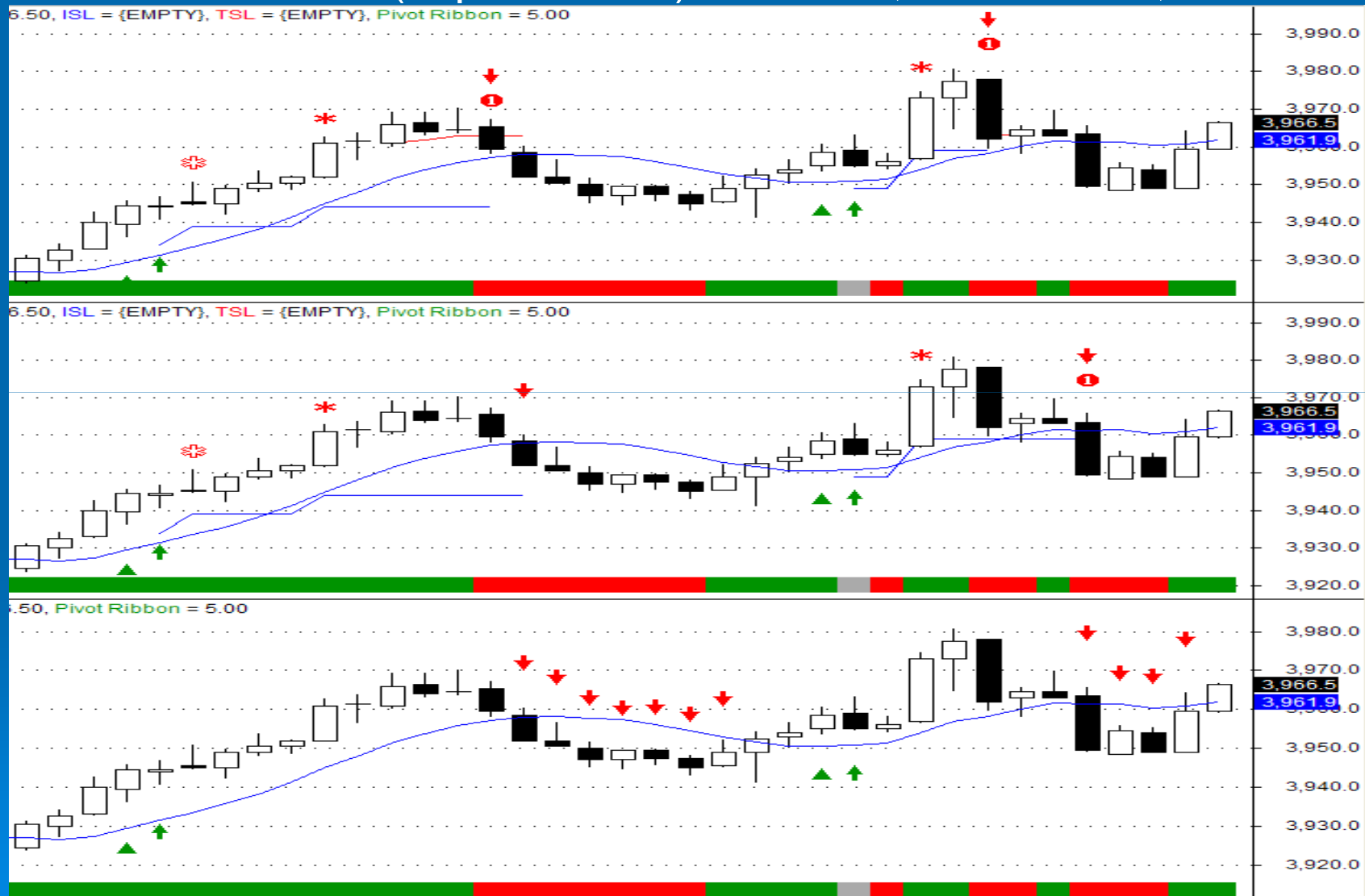# Times are Changing – Exit Strategies

Advanced Exit showing –

➢ Time Stops Exit (squares)

➢ Trailing stops Exit (Down arrow with a 1)

➢ Hollow Star (Lift Initial Stop to half Risk) (I.S. = 10 Points)

➢ Solid Star (Lift initial stop to breakeven – Free Trade)
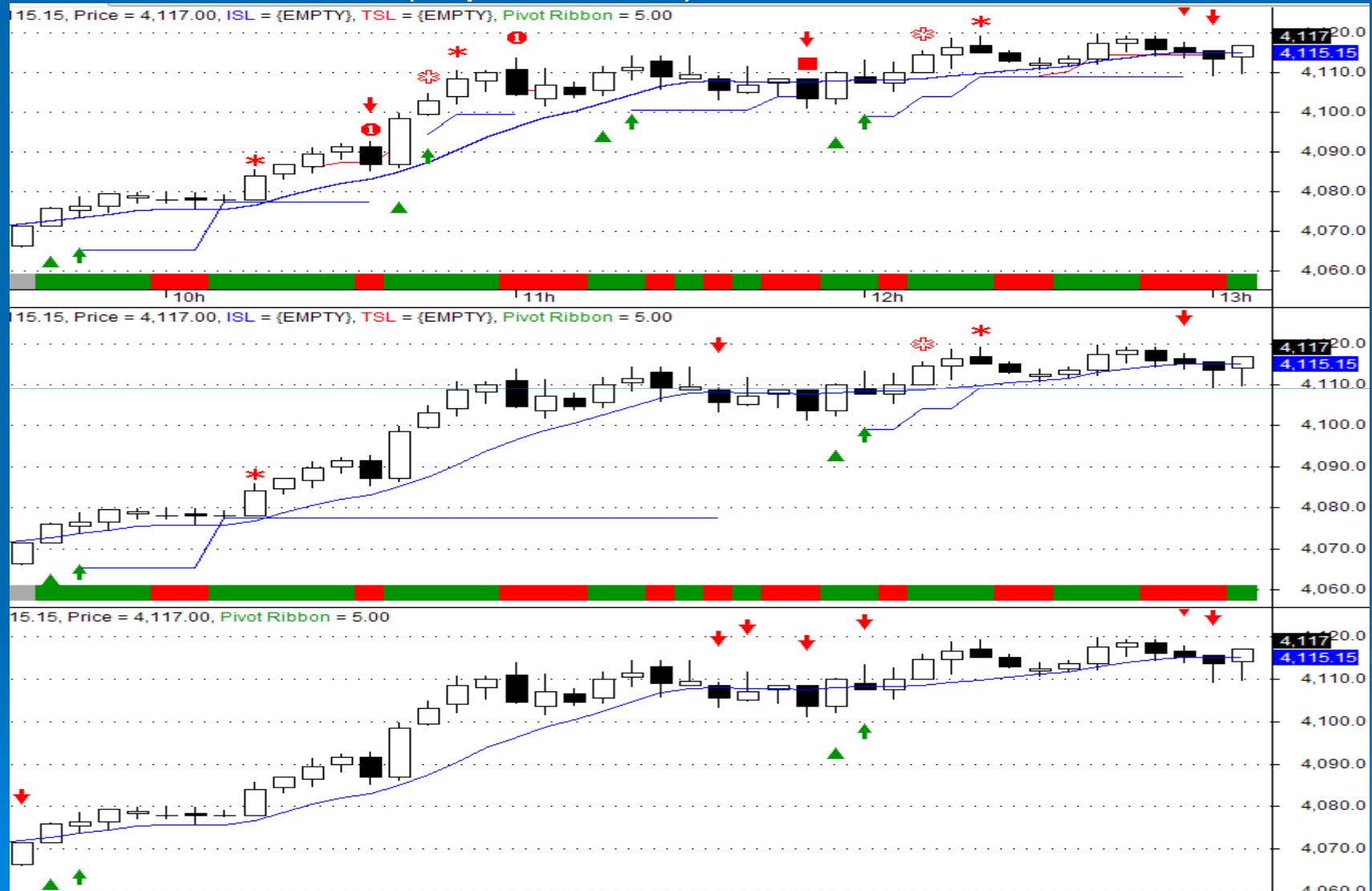
Green Triangle = Setup, Green arrow = Buy at open
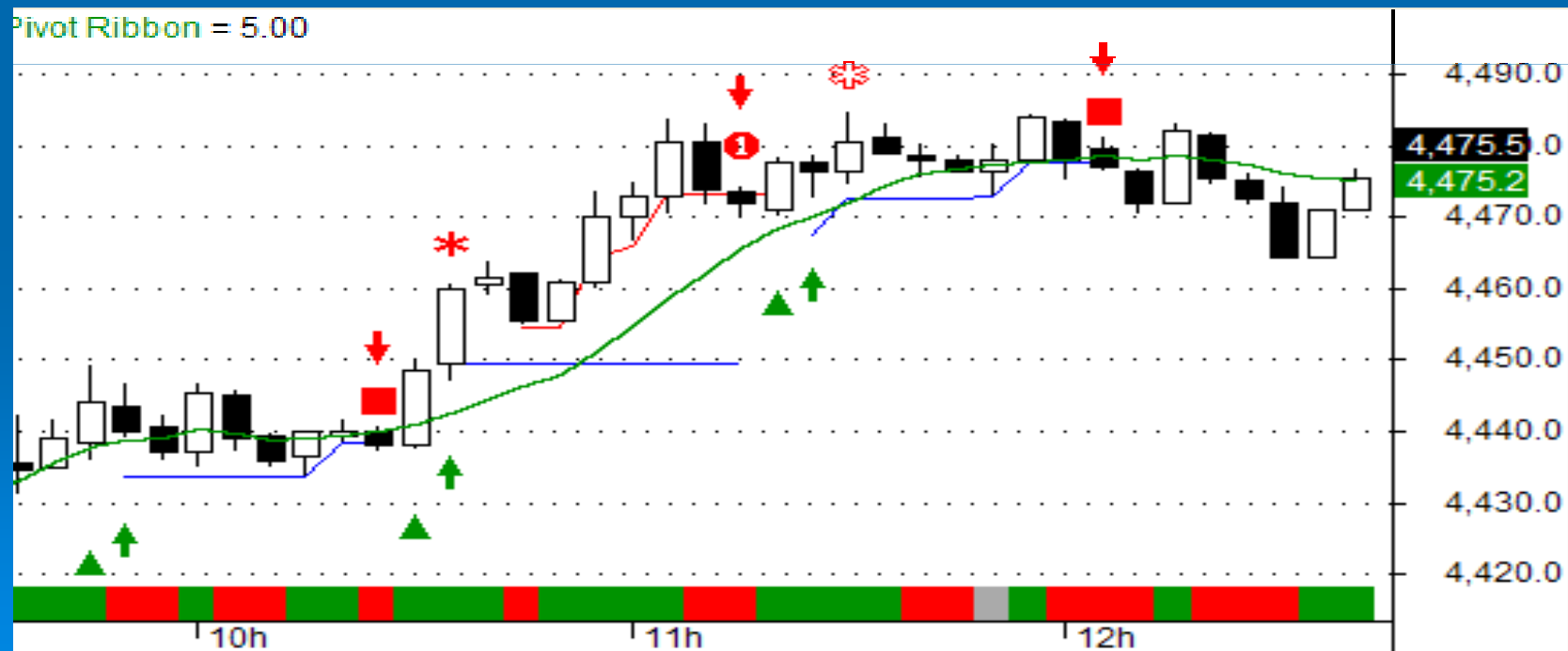
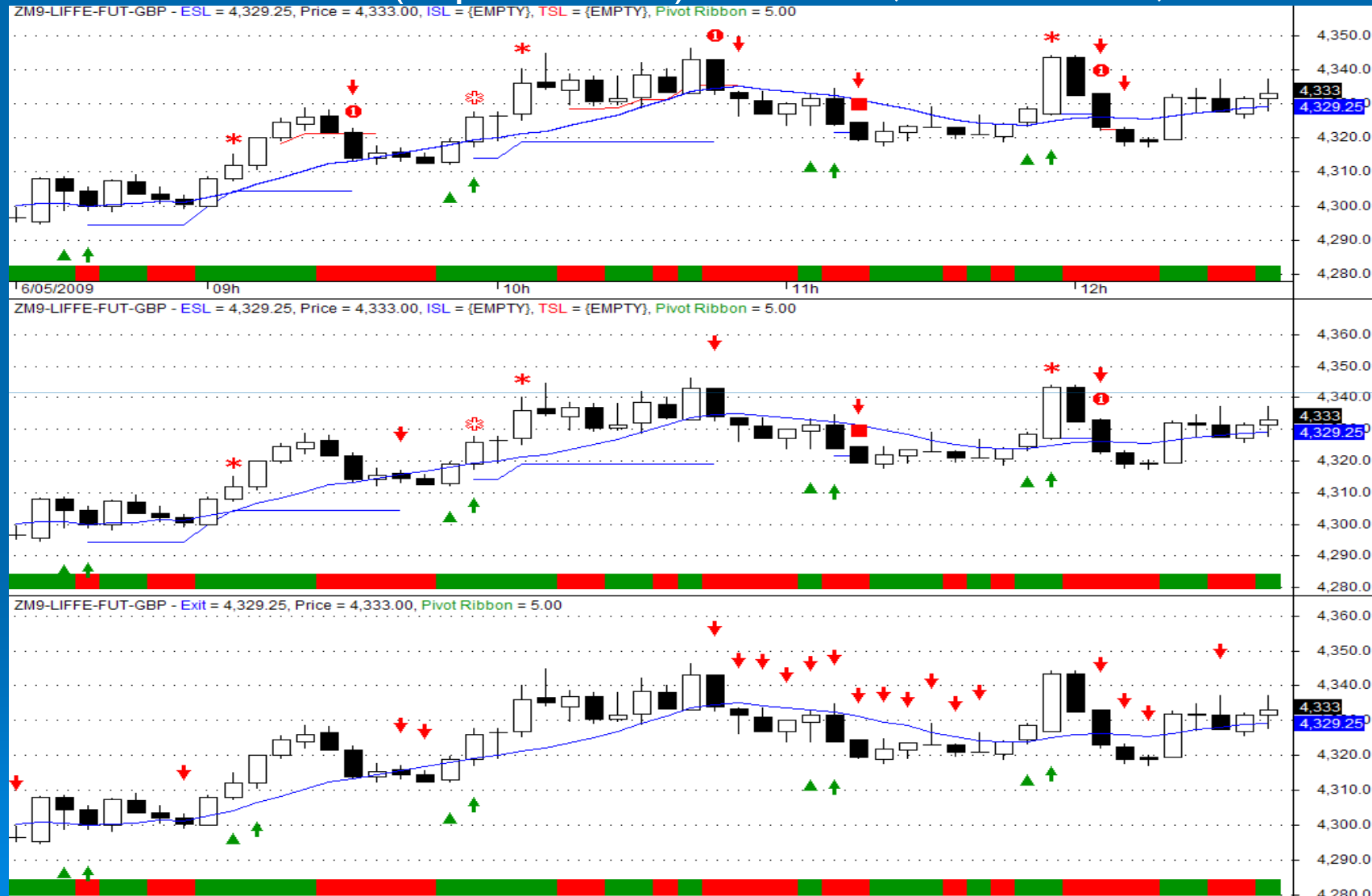# Times are Changing – Exit Strategies
## All three Exits – (Top to Bottom) Advanced, Intermediate, Basic

# Times are Changing – Exit Strategies
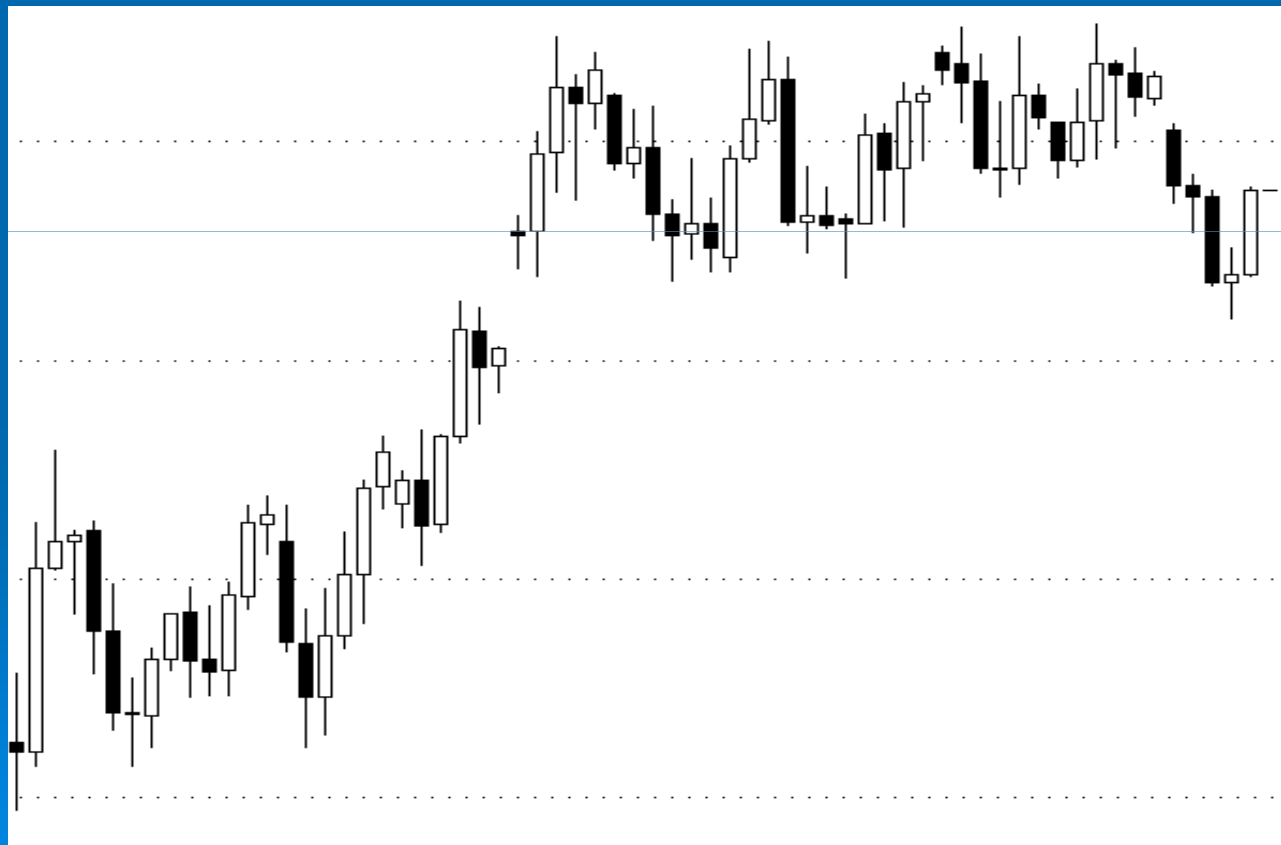## All three Exits – (Top to Bottom) Advanced, Intermediate, Basic

# Times are Changing – Exit Strategies
## All three Exits – (Top to Bottom) Advanced, Intermediate, Basic

# The above system was tested on the FTSE100 ,over 01/04/2009..19/06/2009, using 5 min bars.

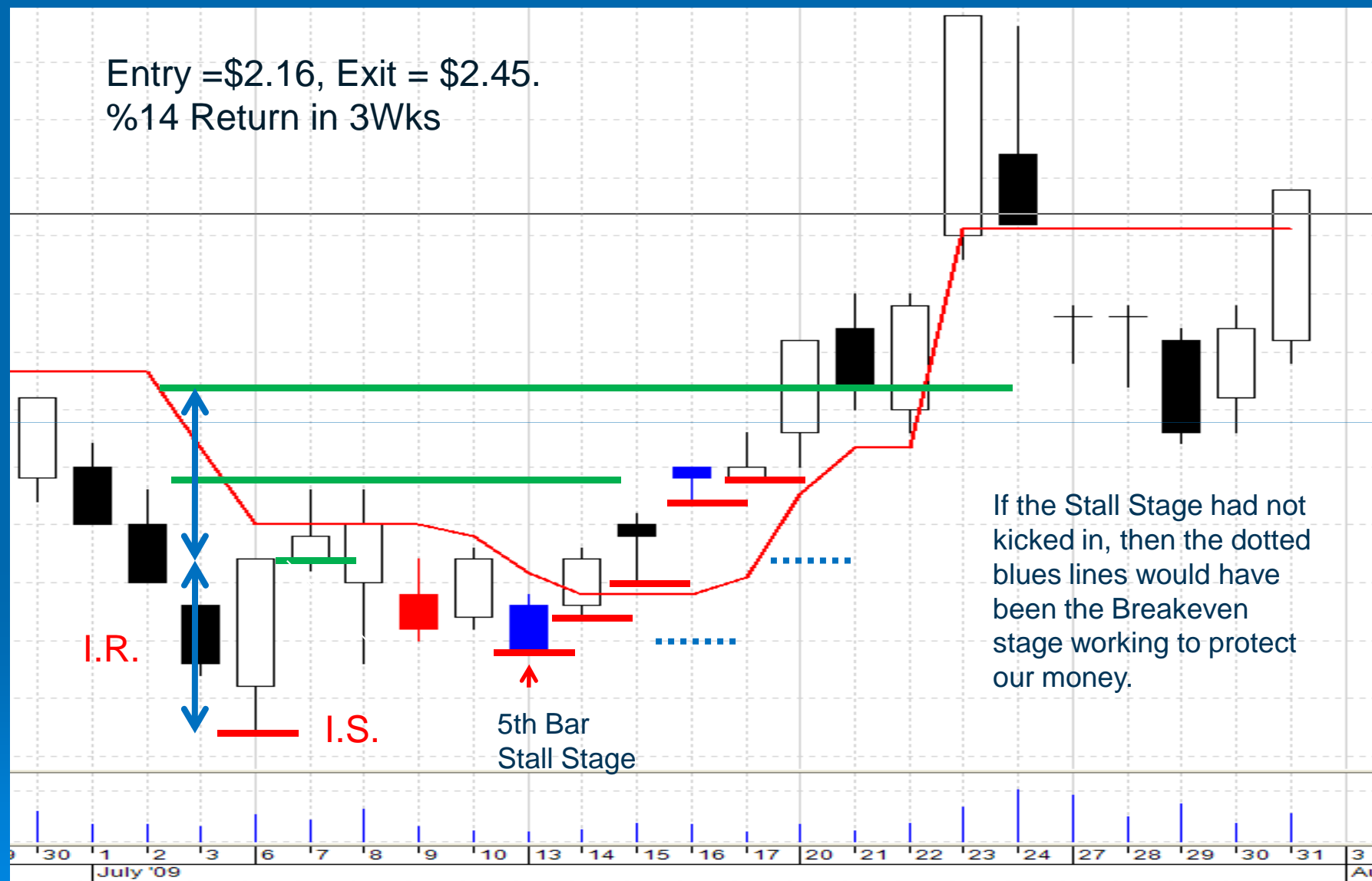Below are daily bars representing this period.

# Exit using Parabolic SAR (0.2,0.2) or MACD(5,10)

# MAP – Daily Chart

Entry =$2.16, Exit = $2.45.
%14 Return in 3Wks

If the Stall Stage had not
kicked in, then the dotted
blues lines would have
been the Breakeven
stage working to protect
our money.

I.R.

I.S.

5th Bar
Stall Stage

July '09

# In Conclusion

Ensure you have a good Entry Strategy first.

Do not use the coin toss.

Then follow with a good Exit Strategy that complements the Entry. Ensure that all of the Exit stages are considered.

Then the profits will follow.

Exit Strategies

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