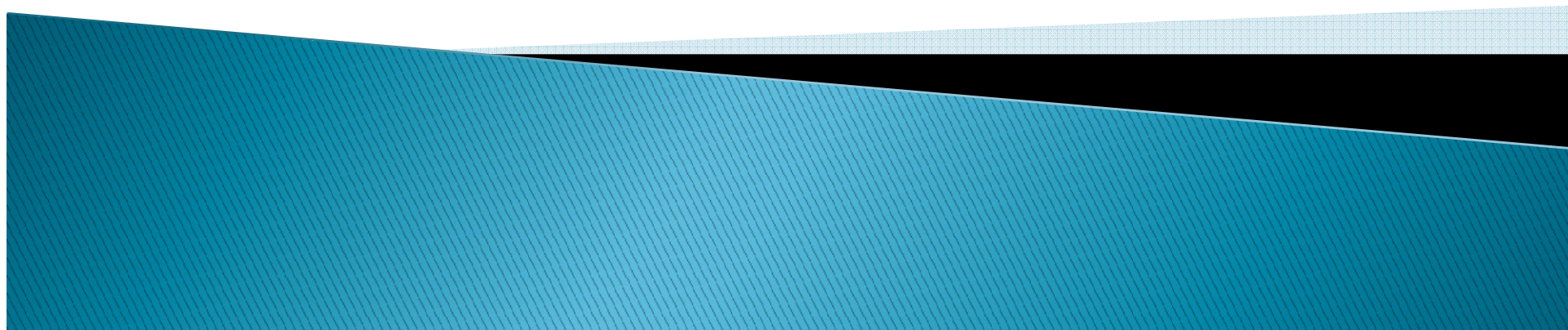


The Business of Trading the Financial Markets

Anatomy of a Trading Plan

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Forward

This presentation is a combination of my own personal ideas and beliefs as well as a compilation of ideas from books, journals and guest speakers at the ATAA.



A specific trading plan must be tailored to suit each individual. This allows them to apply their own unique thumb print to the plan.

The primary component of financial success
in the markets is –

**”A Business Trading
Plan”**

Overview

The ultimate goal of trading is to make money.
No different to any other business.

In order for a business to be successful, we must have a business plan. Without a business plan that is well designed, structured and written down, no bank (or wife) will ever lend you money to start up the business.

So why should we treat financial trading of the markets any different.

Why use a Trading Plan

A trading plan defines the reasons, rules, rewards and targets for conducting the business.

Without a plan in place, we are apt to wander aimlessly through the markets, making donations (losses) from one money game to the next.

The act of creating, writing down and prominently displaying our trading plan, helps prevent us deviating from our intended methodology and keeps us guided towards profits.

Components of a Trading Plan

Part 1

- Reason for Trading
- What markets to trade
- Money Management & Allocation
- Trading Strategies
- Rules for when we are losing
- Rules for when we are winning

Components of a Trading Plan

Part 2

- Evaluation
- Daily & Weekly Tasks
- Goals & Rewards
- Education
- Emergency contingencies

Components of a Trading Plan

Part 1

Reason for Trading

Defining this helps us understand what we aim to achieve out of this business.

Examples :

- ▶ Is trading purely a social event?
- ▶ An adjunct to our existing 9 to 5 job?
- ▶ An addition towards our retirement fund?
- ▶ Will this be our sole source of income?
- ▶ Financial independence
- ▶ Freedom – Trade from anywhere
- ▶ Your own boss
- ▶ Mental challenge & stimulation



Reason for Trading – Example

- ▶ Secondary income after workplace accident & insurance payout.
- ▶ Only able to sit for short periods of time due to injury.
- ▶ Ideal strategy would involve trades of that are of a 1..10 day duration.
- ▶ Overseeing the trades during the morning and afternoon sessions



What Markets to trade

- ▶ Shares
- ▶ CFDs
- ▶ Options
- ▶ Bonds
- ▶ Futures
- ▶ Forex
- ▶ Etc

It is not only the market type but also the time period that needs to be decided on.

This decision should also be reflected in the “Reason for Trading” area of our plan.



What Markets to trade – Example

I plan on trading the following instruments –
CFDs on the top ASX 100 shares.

This is due to CFDs being able to be traded long as well as short and the additional buyer power (leverage).

I must exercise care in trading CFDs due to this leverage and ensure that my stops are adequately set to reflect the true value of the position.

For CFD trading I will be using a short period (3..8 day) trading strategy. This will be in line with “Oliver Velez” style of trading.

Futures – SPI

I will use the SPI for intra day trading. For this I will be using a squeeze play strategy.



Money Management

In this area we define our money parameters for our overall plan and specific strategies.

We should nominate how much money we will allocate to each strategy and what the rules will be for with drawing of profits.

- ▶ Trading Account composition
- ▶ Maximum Risk per strategy
- ▶ Position Size
- ▶ Profit Goals
- ▶ Profit Retention
- ▶ Rules for when we are Losing
- ▶ Rules for when we are Winning



Money Management

Trading Account composition and Maximum Risk per strategy – Example

I will use a \$50,000 trading account.

This will be broken up into two areas as per my trading strategies.

CFD Trading –	\$30,000.00
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SPI Futures Trading –	\$20,000.00
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Money Management

Trading Account composition and Maximum Risk per strategy – Example

CFD Trading

For CFD trading I will create a separate trading account that will have \$30,000 allocated to this account.

The maximum number of CFD positions I will hold at any one time is 10. This helps me to mentally track and manage these trades. The maximum that I will risk at any one time will be 1% per position with a maximum of 5% for the whole account.



Money Management

Trading Account composition and Maximum Risk per strategy – Example

SPI Futures Trading

For this strategy I will only be trading 1 contract at a time.

The margin is \$8000 per contract, hence the reason for allocating \$20,000 to this strategy.

The maximum to be risked on any one trade is 10 points or \$250.00



Money Management

Profit Goals – Example

SPI Futures

Income goal is \$50,000 per year, full time trading.

$$\$50,000 / 12 = \$4170 \text{ per month}$$

$$\$4,170 / 4 = \$1050 \text{ per week}$$

$$\$1,050 / 5 = \$210 \text{ per day}$$

This equates to 10 points per day.



Trading Strategies

Trading Strategies must be clearly defined and contain the following :

- Market
- Maximum Position Size
- Risk to Reward Ratio
- Expected return per trade
- Initial Stop criteria
- Entry criteria
- Exit criteria
- When to trade
- Emergency contingencies
- Example chart
- Example Log



Trading Strategies – Example

Strategy Name – The ANTI. (Linda Bradford Raschke)

- Market = CFDs on the ASX100
- Maximum Risk per trade = 1% of Capital = \$300 = \$3000 CFD
- Maximum Position Size = 10% of Capital = \$3000 = \$30000 CFD
- Risk to Reward Ratio = 2.5:1
- Expected return per trade = \$290
- Initial Stop criteria = Below the Bar of Entry
- Long Entry criteria = This trade is based on the Stochastic Indicator.
It looks for a turn up of the %K after a momentary dip.
- Long Exit criteria = Usually 3..5 bars or break below 5SMA or 8SMA depending on the strength of the trend.
- When to trade = 10:00AM to 4:00PM – Full AUS Trading
- Emergency contingency's = Gap Exit Strategy



Trading Strategies – Example

Strategy Name – The ANTI. Sample Chart showing trade



Trading Strategies – Example

Strategy Name – The ANTI. Sample log of trades

Trades 1 - 25										ComeToMe												
Profit / (Loss) for group		\$3,925.00		Profit Trade Percentage				67%		Average Income Trade Amount				\$2,275.00		Current Capital				\$23,925.00		
				Loss Trade Percentage				33%		Average Expense Trade Amount				(\$500.00)		Potential Trade Dollars at Risk				\$0.00		
										Commissions				\$125.00		Potential Percentage at Risk				0.00%		
Trade #	Entry Information								1st Exit				2nd Exit				3rd Exit				Trade	
	Symbol	Cnts	Date	Dir	Price	Time	Target	Stop	Contracts	Price	Date	Time	Contracts	Price	Date	Time	Contracts	Price	Date	Time	P/L	Cmsn
1	SPI	1	27-Nov-07	L	6382	10:05	6409	6371	1	6395	27-Nov-07	11:05									\$325.00	\$ 25.00
2	SPI	2	31-Jan-08	L	5458	10:35	5501	5450	1	5501	31-Jan-08	11:05	1	5584	31-Jan-08	12:00					\$4,225.00	\$ 50.00
3	SPI	2	31-Jan-08	L	5590	13:55	5666	5580	1	5580	31-Jan-08	14:05	1	5580	31-Jan-08	14:05					(\$500.00)	\$ 50.00



Money Management – Rules for when we are losing

In this area we define what our draw down rules will be.
This not only protects are account but also psychologically
protects us during periods of draw down.
The psychological aspect is as important as the financial aspect.

Questions to be answered are –

- ▶ What is my daily maximum draw down?
- ▶ What are my weekly drawdown rules?
- ▶ What are my monthly drawdown rules?



Money Management

Rules for when we are losing – Example

- ▶ My daily maximum draw down is 2% of the account
If this is reached, then I stop trading for the rest of the day.
- ▶ My weekly maximum drawdown is 5% of the account.
If this is reached, then I stop trading for the week.
- ▶ My monthly maximum drawdown is 15% of the account.
If this is reached then I stopped trading completely and re-evaluate my trading plan and strategies.

Until I have found the fault/faults with either my strategies or trading plan, all trading remains stopped.



Money Management

Rules for when we are winning

Winning => Euphoria => Reckless trading

So for this reason, lots of the professionals in the markets will tell you that it is a good idea to leave some on the plate.

“Be grateful for what you have, for it is easily lost.”

Rules for Winning:

- ▶ Daily Profit Target
- ▶ Weekly profit Target
- ▶ Monthly profit Target
- ▶ Yearly profit Target



Money Management

Rules for when we are winning – Example

- ▶ If I reach my 2 * Daily Profit target and the next trade is a loss, then I quit for the day.
- ▶ If I reach 2 * my Weekly Profit target before the end of the week, then I take the rest of the week off.
- ▶ If I reach 3 * my Monthly Profit target before the end of the month, then I take the rest of the month off.
- ▶ If I reach 2 * my Yearly target with a quarter of the year remaining, then I take the rest of the year off.



Traders are blocking the SG building parking area, protesting against the fact that they will not receive their bonuses this year



Anatomy of a Trading Plan

End of Part 1



Anatomy of a Trading Plan

Components of a Trading Plan

Part 2



Evaluation

Individual Trades

It is important to make a hard printed copy of each trade and document the key points about this trade. Each trade should also have two scores awarded.

- The first for the success/failure of the strategy
- The second for the success/failure of the trader



Evaluation

Overall Strategy evaluation

It is important to generate an overall strategy profit report. This should have a predefined means of displaying when the strategy is profitable and when it should be placed on hold.

Overall Trader Evaluation

It is important to monitor your own performance. This is a reflection on how well you are performing as a trader. A profitable strategy can be turned into a losing strategy by a trader that does not follow the rules.



Evaluation

Point Score Rules – All Trades will be rated as follows

► Overall Strategy Evaluation

1. Target Hit. (Perfect)
2. Out at a different price, but profitable.
3. Out at Breakeven.
4. Out at a different price from stop but a losing trade.
5. Stop Hit.

Overall Trader Evaluation

1. Followed trade as dictated in the plan. (Perfect)
2. Followed trade entry but closed out position before predetermined target was hit.
3. Followed trade entry but removed stop and let position run past original target.
4. Entered setup late and didn't set target.
5. Impulse trade.



Daily & Weekly Tasks

Daily Tasks

- ▶ Prior to Market Open
- ▶ Post Market Open
- ▶ Manage Open positions
- ▶ Pre Market Close
- ▶ Post Market Close

Trade Recording

Strategy Record

It is important to make a hard printed copy of each trade and document the key points about this trade. Each trade should also have two scores awarded. The first for the success/loss of the strategy
The second for the success/loss of the trader.

Financial Record

Every trade should be recorded in a journal. This could be a spreadsheet or alternatively in a journal book.
This should also clearly show any brokerage charges as a separate cost for taxation purposes.



Daily Tasks – Example

07/01/2008

Instrument – ANZ

Strategy– Squeeze Play

Direction – Short

Entry Price – \$27.00

Exit Price – \$25.60

Qty – 1000

Profit – \$1400.00

Strategy Score = 2

Personal Score = 2

Comments

Exited the trade to early.

Did not wait for the 8SMA.

This was due to the short being overdone.



Daily & Weekly Tasks

Weekly Tasks

- ▶ Update Score charts with the weeks trades.
- ▶ Evaluate as to whether the strategy is performing as expected. If not performing, put the strategy into emulation mode for further evaluation.
- ▶ Evaluate Average Personal Score.
- ▶ If possible balance your journal with an accountant statement. Including brokerage and other charges.



Weekly Tasks – Example

Personal Score Card Evaluation.

If the 5 Period average of the personal Score Card, crosses below 2.5 then stop trading.

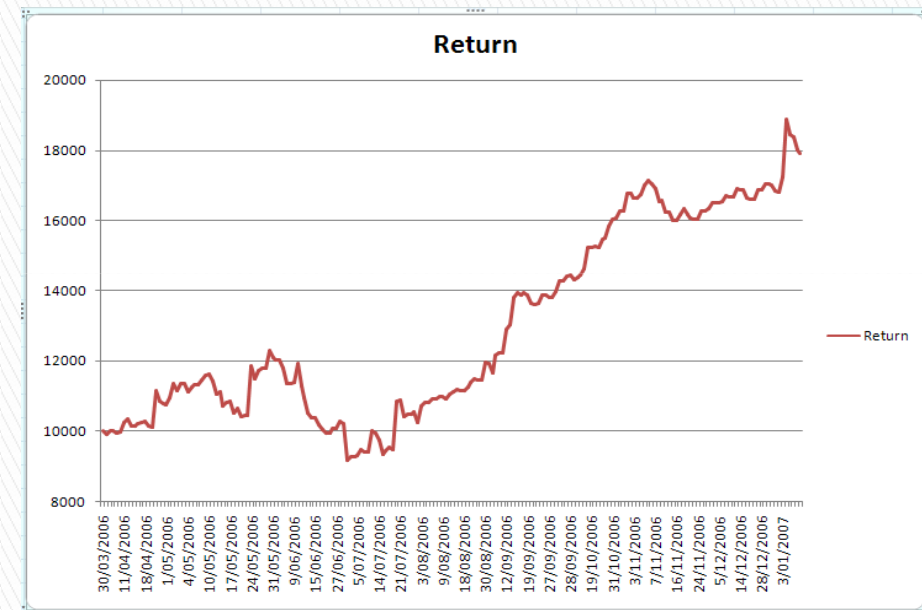
A value below 2.5 on the Personal Score Card, indicates that we aren't following our rules to the letter.

Personal Score Card		Avg Score	1.6
Date	Trade No	Instrument	Score
21/11/2007	1	SQ	1
21/11/2007	2	SQ	2
23/11/2007	1	SQ	3
24/11/2007	1	SQ	1
24/11/2007	2	BO	1
24/11/2007	3	SQ	2
27/11/2007	1	BO	1
28/11/2007	1	SQ	1
29/11/2007	1	BO	2
30/11/2007	1	SQ	1
30/11/2007	2	BO	2
30/11/2007	3	SQ	3
30/11/2007	4	BO	1
4/12/2007	1	BO	1
5/12/2007	2	SQ	2
6/12/2007	3	BO	1



Weekly Tasks – Example

Results of the
MA Cross Strategy

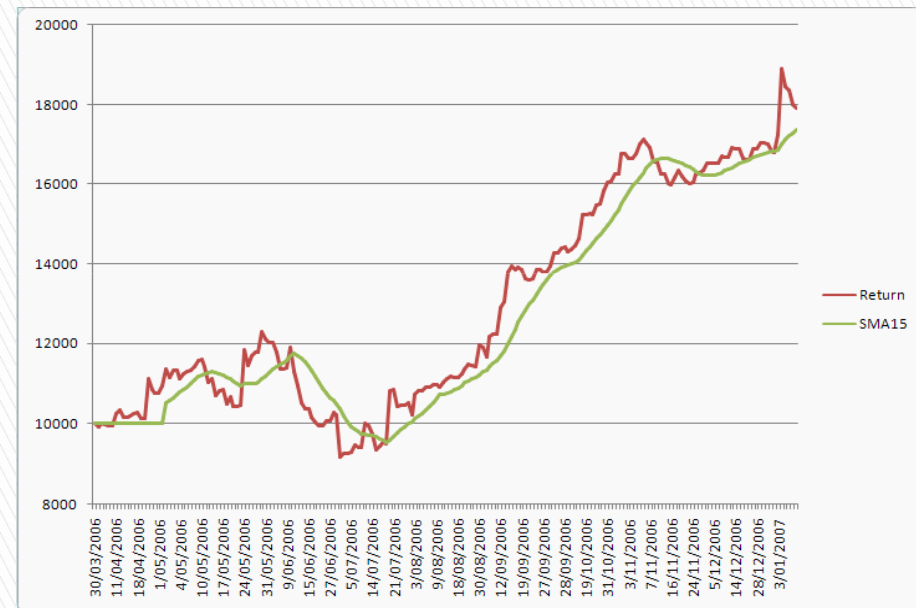


MA Cross Strategy
Evaluation

Weekly Tasks – Example

Strategy Stop

If the return on the “MA Cross” Strategy falls below the 15 period SMA, then STOP physically trading the strategy and put into paper trading mode.



MA Cross Strategy
Evaluation

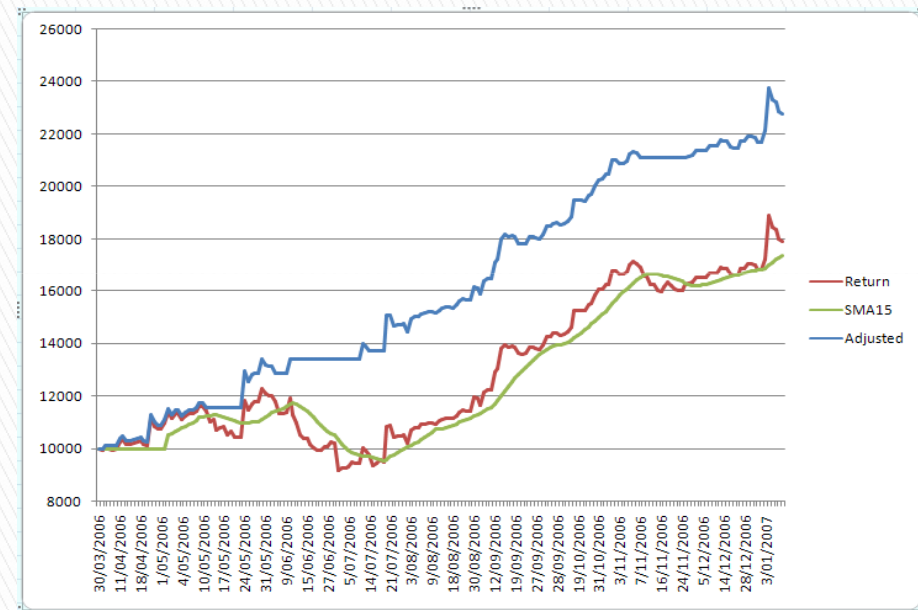
Weekly Tasks – Example

Strategy Stop

Results of the same strategy but using a 15 period SMA as a trading strategy stop.

Note how it stopped the large drawdown's.

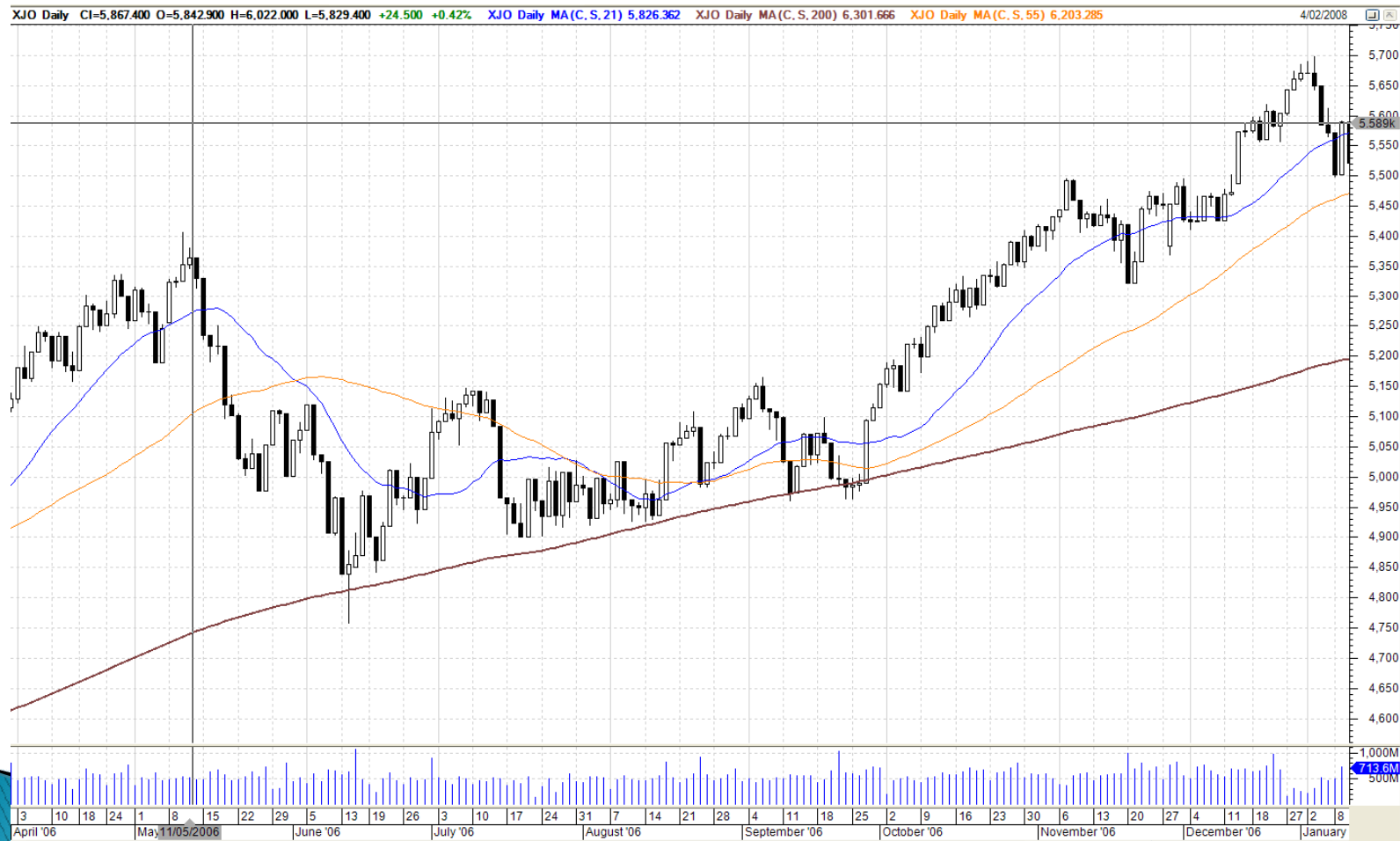
In this case, it returned an additional 50% profit.



MA Cross Strategy
Evaluation

Weekly Tasks – Example

The previous strategy results were based on a system trading CFD's on the Top 100 stocks. Below is the XJO for the same period.



Goals & Rewards

Goals –

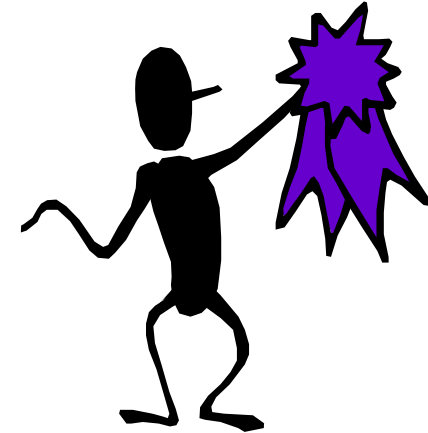
Are an important part of a plan. Without goals we have no means to measure whether we are succeeding or not. As with any business it is important to establish realistic goals.

For each individual strategy, try to pick realistic goals for the day and goals for the week.

If we set our goals too high to start with, we are bound to fail, purely because we become depressed with the fact that we are not succeeding. This then feeds on itself, we start to break our rules to try and climb up faster but fall even further.



Goals & Rewards



Rewards –

It is important to reward yourself for a job well done. This does not mean buying a BMW after your first week of profit, it means rewarding yourself in a small way that gives you an ego & moral boost. We all thrive on praise. This is our own pat on the back for a job well done.

This is not only for when you make a profit but also for when you trade according to the strategy rules.



Education

Use this area to highlight education you wish to partake in this year.

Examples are –

- ▶ Reminiscence of a Stock Operator by Jesse Livermore
 - Read this every year
- ▶ ATAA Conference
- ▶ Van Tharpe Book
- ▶ Trading Conference in Hawaii



Emergency contingencies

We must have a document (preferably pinned to the wall) that details all of our critical information.

For those that travel, a smaller version carried on our person i.e. wallet/purse.

This way when we are travelling we can still ring the broker and close a trade.

This should contain :

- ▶ Brokers Name
- ▶ Brokers phone number
- ▶ After hours brokers support desk
- ▶ Your Account Name
- ▶ Your Account numbers
- ▶ Alternate internet access details
- ▶ Your Mobile phone number
- ▶ Your Secondary phone line number
- ▶ Backup power – UPS



In finishing

There is an old cliché

“If you fail to plan, plan to fail”

*Thank you,
Neil Wrightson.*

What the financial Markets Pro's are up to!



Bibliography & further reading

- ▶ **Trade your way to financial freedom**
By VAN K. Tharp
- ▶ **Street Smarts**
By Linda Bradford Raschke
- ▶ **Tools & Tactics for the Master Day Trader**
By Oliver Velez
- ▶ **Mastering the trade**
By John Carter