Currency Trading Tips

Creating a Trading Strategy

One of the most common mistakes new forex traders do, is that they have no trading strategy. Because of the many appealing characteristics (24 hours, trade both short and long, leverage etc.) most of the new traders entering the market are eager to prove themselves in an often egoistic approach.

Egoistic in that they believe that they can become very profitable and make a fortune in the short term, but soon enough they end up with a bad psychology which at the end accelerates their loosing pattern. In fact, the most successful forex traders are people recognized for their humility and discipline. These qualities are acquired through experience and accepting some simple realities of the forex market.

The first step towards becoming profitable in the forex market is to devise a trading strategy/plan.

Creating a trading strategy is of paramount importance and is actually very easy. To create a successful trading strategy, traders should address the following considerations:

1. Reasoning of the trade: Why buy or sell? Which pair?
2. Timing of the trade: Why now? Before economic news releases or after? Day or night?
3. Trading objective: What is the take profit target? What is the stop loss?
4. Money management.
5. Documentation and analysis of the results.

Before entering a trade there should be a good reason. Many times traders are entering a position because of boredom or just to feel the excitement of being long or short. This is a recipe for disaster! You should always buy or sell any pair on a reason that makes sense to you. Whether this reason is fundamental or technical or both always make sure there is a reason.

What currency pairs will you trade? This sounds simple, but it is easy to get confused if you don't define this. From our experience we strongly believe that is best to concentrate on some (not all) major pairs (such as EURUSD, GBPUSD and USDJPY) and don't waste time with illiquid, choppy pairs. You also have to determine when you will trade and how often you will trade. Are you going to be a day trader or hold positions for a longer period of time? Your schedule and responsibilities may have some impact on that. Should you trade before economic releases or after? Should you trade heavily on nights, during UK open and close etc.? It is important to define these basic ideas to begin to form some consistency and discipline.

The second step is to define your trading objectives. What is your end goal? What is your take profit target and your stop loss limit? Try to place your take profit and stop loss before entering the trade as you can always change that, if something important happens in the markets in the meantime. Most traders tend to take their profits early while letting their losses run. This is because in the inexperienced traders mind-set is very difficult to accept that he/she is wrong. Placing your stop loss at the time you open a trade will help you create discipline and learn that sometimes you will be wrong. Furthermore, most new traders have completely unrealistic goals. Making big returns in the first year of trading is possible but highly improbable.

These unrealistic expectations wipe out a lot of traders before they even had the chance to learn the market. Breaking even in the first year is an admirable goal; many traders do not do that. If a trader makes 20-30% on their initial investment in their first year, that is outstanding.

Money management is probably the most important aspect of trading. First you have to accept that in trading nobody can have a 100% winning ratio and everybody (even the most experienced traders) are sometimes wrong. Accepting that sometimes you might be wrong is again of paramount importance. The key here is accepting you are wrong before your mistake becomes too big. To do that you need to determine how much equity you have to fund you account. Then you must determine how much risk you are willing to take on each trade. Most experienced traders risk 1-4 % of their account balance on each trade. This may look too low to the new forex traders, but will definitely help you avoid big losses, create the necessary discipline and keep you in the market in order to get the necessary experience. Also very important is to have a positive percentage of winning trades compared to losing trades and a positive average profit compared to the average loss ratio. If your average loss is two times your average profit that means you need to make 10 profitable trades to cover 5 losing trades. Keep this in mind.

Along with money management, it is vital to keep track of your past trading and results in order to recognize past mistakes and avoid them in the future. This is just a basic start to having a successful trading strategy in the long run but will definitely help new traders get the discipline required to be profitable in the very exciting Forex market.

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