Trading Forex with Consistency

No. 1 Priority Is Preserving Your Capital

Trading Forex provides an excellent opportunity to earn additional income, or even as a full time career. But too many traders set out without arming themselves with some basic rules and guidelines to follow and the markets are quick to teach them the lessons. We asked trader Stuart McPhee to reveal some of his tips for starting out successfully.

» Determining precisely when to initiate a trade may be one of the most difficult decisions foreign exchange (forex) investors face. It is what is referred to as the entry signal and figuring out a consistent way of entering and exiting a position is an extremely important trait for all traders to have.

Most people trade forex randomly, indiscriminately, and without any process or methodology. These folks will stare at a chart to see if something jumps out at them. Even if they have to stare at it for a few minutes, they will keep on looking until they find something.

A trading opportunity may magically appear because a chart looks strikingly similar to one that they saw in a book they read on the weekend. Maybe the author of that book said to trade it, so they do, even though they have never traded for the reasons outlined in the book and may never again. That is not trading with consistency and it is a terrible way to look for new trading opportunities.

The author often talks to people about his three "c-words" concerning trading: comfort, confidence, and consistency. You need to be comfortable with the level of risk you are taking when you trade, a healthy dose of self-confidence, and a trading plan that suits your personality that you consistently apply each and every time.

When looking at a chart, the author could tell you within a second whether or not it is a likely opportunity for him. How? Based on his own personal trading plan, he knows what his strategy is, and he knows exactly what it looks like on a chart because he has seen it thousands of times.

You, too, should consider committing to mastering one trading set-up and executing it consistently. Take a mental picture of what your perfect set-up looks like and burn that template into your mind. Now, when you see a chart that doesn't match your template, you are able to eliminate it quickly and move on.

Consistency Produces Results

What should your strategy be based upon? Good question. Although it's related, the answer also leads to an entirely different discussion regarding analysis, probability, profit expectation, and other factors.

Trade Like a Casino

Many people hold trading in the same regard as gambling but it is an unfair comparison. Trading is not gambling unless you are trading blindly, randomly, without adhering to a trading plan and completely ignoring any risk management. However, it is useful to consider a casino's point of view using the example of a roulette wheel, as casinos are the greatest exponents of consistency.

As the roulette wheel and table include a zero – in some cases it also has a double zero (00) – the odds are slightly tipped in the casino's favour. The presence of the green squares on the roulette wheel and on the table are technically the only edge the house has, but that is all it needs. The casino applies that edge with absolute consistency over an extended period of time.

For example, if you place a bet on one of the numbers, your payout is 35 to one, i.e. 35 times your bet. However, the odds of winning are one in 37 (assuming no double zero). Outside bets (if you place a bet on one to 18, 19 to 36, red or black, even or odd) will always lose when a zero comes up.

Does the casino make money every time the white ball is released onto the spinning roulette wheel? No, it does not. Over time, however, the house certainly does win. Casinos have a set of developed rules that give them an edge over any gambler, and they apply those rules consistently and without exception.

You need to strive for the same level of consistency executing your trades. If you are trading randomly using a variety of different entry set-ups, you will likely find yourself trapped in a confounding maze of indecision while hopping from one strategy to the next.

Being consistent means that when you see a potential trading opportunity that does not meet your entry signal rules, you don't trade it. It doesn't matter if it is a classic break higher from an ascending triangle or if it's the perfect moving average crossover that you read about on the weekend. If it doesn't meet your entry conditions, ignore it and move on.

Go with What You Know

The author has been told many times – and he is not ashamed to admit – that his trading style is boring. It may indeed appear to be monotonous, and if it is, it is due to consistently adhering to the trading plan.

If it's exhilarating thrills and spills you seek, consider skydiving or some other adrenalin-inducing activity. Forex trading can be exciting at times but it's not the type of activity one should engage in for thrills.

Regardless of what it is you want to achieve by trading forex, your No. 1 priority should be preserving your capital. Approach forex trading as you would run a business. As any successful business owner will tell you, irrational emotions have no place in their decision-making processes, and trading is all about decision-making.

For many, wading through what they regard as a sea of potential trading opportunities – stocks, commodities, and currencies – is a daunting experience. Using software to filter out potential trades that don't meet your criteria can help reduce the noise and leave you with a small, manageable list to manually scan. Not only can this be a great time-saver, it also helps maintain consistency, as you may not even look at a chart unless it meets your entry signal conditions.

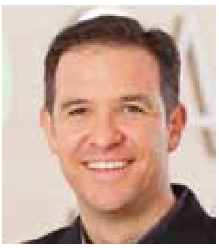
Some investors will restrict their focus to trading only a few items at one time. For example, some may trade less than five currency pairs at once, and as they stick to a disciplined trading regimen, they don't need to trouble themselves sorting through mountains of data.

Remember, consistently executing a trading plan, from entry to position-sizing to exiting, is extremely important. Know your trading set-up and don't deviate from it. Doing so won't lead you to a treasure trove of undiscovered riches, but it could help you to eliminate the pain of unnecessary trading losses, and in turn, keep you in the game.

Conclusion

As an early stage trader, start small and identify one strategy that suits your risk profile. Then master this strategy until you can use it to generate consistent returns. Don´t be put off if your trading appears to be boring – and remember to always preserve your capital. «

Meet Stuart McPhee at the London Investor Show FOREX 2014 on February 21.



Stuart McPhee

Stuart McPhee is OANDA's Currency Technical Analyst. He specialises in technical market analysis of major currency pairs. He is the author of several bestselling trading books, most recently the fourth edition of his popular book "Trading in a Nutshell". He produces articles and videos on the how-tos of technical trading. Based in Australia, Stuart speaks at conferences and events worldwide.