

MY TRADING PART 1

By Simon Mawby

In this series of articles I will outline the markets I trade, the tools I use to find trades, the setups I look for and stop methods I employ and my position sizing model. I have been involved in the markets for 20 years and trading for 14 years. I originally started in shares using fundamental based information for making decisions, but quickly realised that the fundamentals didn't always tally with the movement in price. A couple of disastrous trades where the price spiralled ever lower while all the commentators were still upbeat on the prospects of the company sent me in search for answers. For those of you old enough to remember I am referring to that once favourite mining stock Pasminco.

Watching Pasminco slide out the back door taking my capital with it when management assured everyone all was still well, had a lasting effect on me. While I wouldn't recommend everyone do it, it certainly makes you reassess your approach to the markets. It certainly did with me and while I had dabbled with charting I didn't really understand the concepts behind using it for trading. I had always traded certain shares when they approached a particular price level and consequently sold them mostly at a profit. I didn't realise at the time I was using lines of support and resistance, I just knew it worked.

My journey to trading happened while I was travelling through Alice Springs where I picked up a copy of Daryl's first book, Share Trading. I read it in a couple of a days and the idea's presented in the book appealed instantly to me and this sent me on my path to trading using charts .

Position Sizing

I will address position sizing first as it is the single most important issue to understand and to follow without exception if you wish to trade profitably over the long term. Regardless of your trading style, chosen trading instruments, entry set ups or stop loss methods, if you do not practice a sound position sizing strategy you will fail.

I would encourage all readers to read *Trade Your Way to Financial Freedom by Van Tharp*. The book offers some good information on trading, but the massive benefit is the introduction of the use of *R* and what he calls *Expectancy*. I recommend you read and re-read these sections and then apply the modelling to your old trades to see how structured your money management really is. I initially read this book with very little benefit to my trading as most of the book is very broad. It was only upon re-reading the section on *R* and *Expectancy* and then using an Excel spreadsheet to compare all closed trades to each other, that the power of this simple concept became clear. Had I kept *R* constant, my profits would have been much greater on almost every trade, easily out weighing slighter larger loss amounts on losing trades. Adopting these principles has made my trading more profitable considering my win/loss ratio and my trade set ups have not changed.

My position sizing model is based upon placing no more than \$1000 of capital at risk on any trade. My maximum capital per trade is no more than \$20,000 (depending on available capital) but I rarely set a position of this size due to the risk cut off point of \$1000. Why \$1000? The answer is simple but very important. If you are serious about trading and wish to pursue it, you must be totally honest

with yourself about your ability to close a losing trade with no emotion or hesitation and then be prepared for the next trade.

We all have different loss thresholds, and mine through trial and error is \$1000. I can instantly close a trade showing a loss below this level, but if the loss grows and approaches say \$2000, I will still close the trade, but I find my mind will linger on the loss which will compromise further trades. This is a level that hurts me, so it is best to set up all trades to avoid this occurrence.

The following table of a recent trade illustrates my sizing model :

TGR		Position Size		
			\$20,000	\$ at Risk
Entry	\$3.570			
Stop	\$3.440	Number of shares	5,602	7692
Risk (R)	\$0.130	Total Cost	\$20,000	\$27,462
Target	\$4.000	Risk Amount	\$728.29	\$1,000
R Multiple	3.31			

The trade was for Tassal TGR with an entry at \$3.57, a stop at \$3.44, an initial risk (R) if stopped out of 13 cents and an initial target of \$4.00. Using the risk amount of 13 cents, the potential position sizes are shown in the right hand columns. The two columns show the trade set up using a maximum size of \$20k or a maximum risk of \$1k. With this trade the \$20k position size was used, as this set the loss if stopped out to \$728.29 (below the \$1k limit).

Tools

I will detail my choice of trading tools here simply to point out that you don't need the latest cutting edge equipment to trade profitably. I only have one broker (Commsec) and one CFD provider (CMC Markets) and have used them successfully for many years.

I use Metastock version 7.2 for all my charting which for those interested was designed to run on Windows 95. My default screen uses bar charts with black for up days and red for down days. I also display two exponential moving averages of 13 & 26 days. I find these give an instant feel of the trend direction and the separation distance is a good gauge to the trend strength. My end of day data is supplied by Melbourne based Almax Systems. For intra-day trading I simply use the 1 minute charting via the CMC Markets platform. Naming these companies is not meant to be an endorsement of their services or products it is just simply to illustrate all the necessary products are easily obtainable close by.

My hardware consists of my laptop containing Metastock and Excel and a high speed reliable internet connection both at home and when away. I also have a desktop computer with a large screen that I prefer to use while trading the XJO and FTSE indexes via CFD's. This also acts as a backup to my laptop. These two computers are used exclusively for trading which helps keep them clean, virus free and functional.

Trading

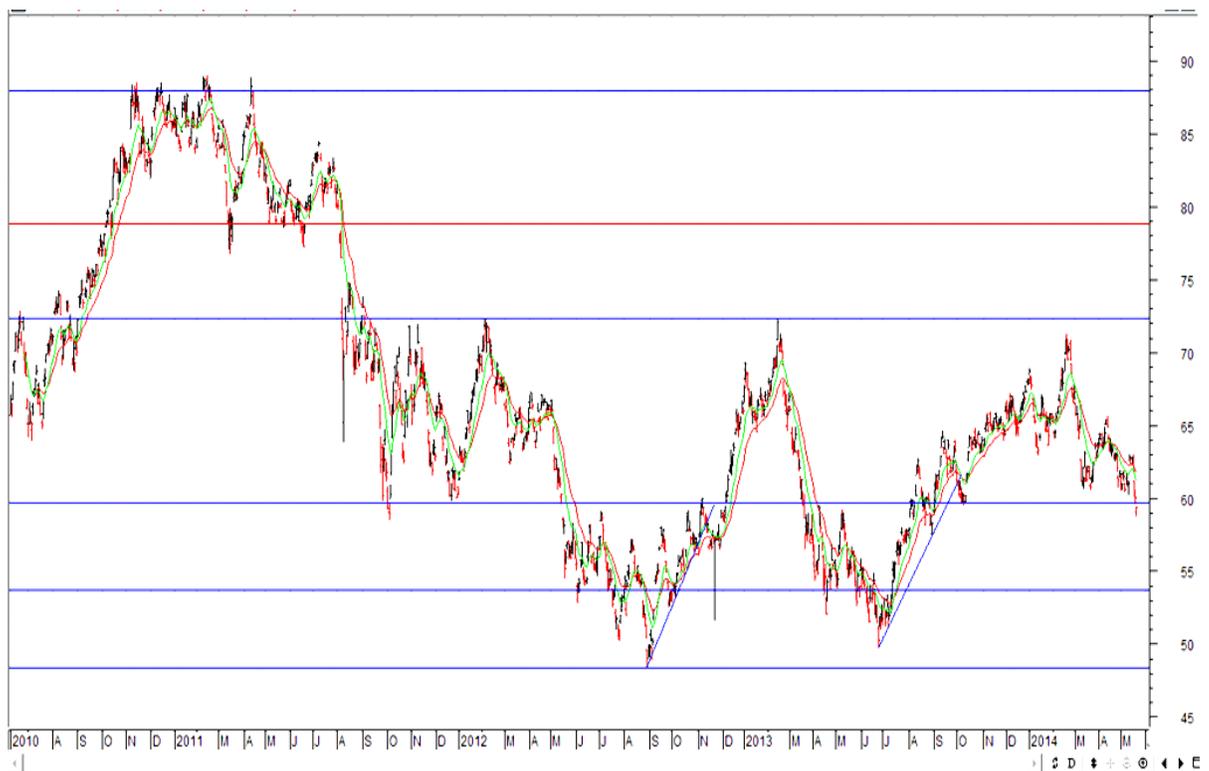
My trading style is based on the premise that price is the most important detail and that most available current information is reflected in the price. I say most, as there is always room for left field events! It should be no surprise that based on this fact I favour heavily the use of support / resistance lines for my trading.

The core idea behind the formation of these lines is best described by Alexander Elder in *Trading For a Living* "*support and resistance exist because people have memories*". Not all shares develop these areas, so the secret is to study the charts and when you find successful candidates monitor them often as they will provide reliable low risk trading. I find these lines when they appear in shares, commodities and currencies very reliable, but when applied to indices they should only be used as a broad guide. The reason behind this goes to the core of how these lines are formed i.e. many traders actually traded the equity at that price.

An index is not the same. An index is a calculated figure made up of many variables and its construction constantly changes over time. For instance the widely quoted Dow Jones Industrials Index is made up of only 30 companies and changes to only include the best performing stocks. A quick look at its construction shows it has included General Electric (GE) since 1907 and NIKE only added in 2013. Therefore its actual value is totally meaningless and should only be used as a relative indicator, not an absolute indicator.

Take a look at the chart below to see a good example of a share that exhibits very strong and highly tradable areas of support and resistance. You may be surprised at the name.

RIO TINO Chart



RIO makes for a great trading share. It has huge liquidity, it respects its lines of support / resistance with confidence and can be traded from the long side with shares or from the short side via CFD's. When trading using support & resistance lines, depending on your level of aggression, you can place orders in advance in the expectation of deflection / reversal / breakout or watch and wait for the move to be confirmed .

Next week we look at two other trading methods