Audio Transcript of the Managing Your Trading Strategy Video Lesson

Hello my name is Trevor Neil and I would like to welcome you to this video lesson which is one of the advanced online learning modules for the three-month Institutional Trader Programme developed by Knightsbridge Trading Academy in association with London Stock Exchange Group Academy. This lesson is divided into four modules. In Module 1, we look at the importance of keeping up to date with news and how to do this. In module 2 we evaluate the importance of updating your trading plan over time. The third module looks at how to close out trades to maximise results and in the final module, we look at how to take profits and cut losses.

Now let's turn to Module 1.

Module 1

Now you are in the market. Time to sit back and let the market do its thing, right? Trading intelligently is not like betting – placing your money on a number and waiting for the spin to decide whether your win or lose. Trading the market is different. It is dynamic, the odds change mid-trade, the wheel can speed up or slow down but you have a lot of control. New information and price developments create new opportunities and alter the game. Actively managing your trade when you are in it is just as important as the decision-making that went into getting into the trade in the first place.

No matter which trading style you follow – fundamental or technical, you must keep up with market news and price developments while your trade is active. Unexpected news comes into the market at any time. We inhabit a hazardous world. Some news is predictable, some is shocking.

The starting point for any trading plan is determining how much you're prepared to risk, which is ultimately expressed by the size of the position and the pip distance to the stop-loss point. This is covered in other videos.

When we talk about making changes to the trading plan, we're referring only to reducing the overall risk of the trade, by taking profit (full or partial) or moving the stop loss in the direction of the trade. The idea is to be fluid and dynamic in one direction only: taking profit and reducing risk.

One way to follow the market from a distance is to set alerts from either your charting system or your trading platform. A *rate alert* is an electronic message that alerts you when a price you've specified is touched. Alerts are a great way to keep tabs on the market's progress. Alerts on charting systems usually have the capability of alerting you to price developments only while you're logged on to your computer and the charting service. With charting systems, you're able to work on other tasks on your computer and keep the charting system minimized or in the background. If your requested price level is hit by the market, the chart system will typically start beeping or flashing and send a pop-up message. Most forex brokers' platforms will send rate alerts to clients via e-mail or text message to your smartphone.

When you are deciding which charting service and broker to use, make sure to find out if alerts are available, what systems are required, and which devices are served. Can you receive alerts on your phone or tablet?

Alerts are a convenient way to follow the market remotely, but they are not orders and should never be substituted for stop-loss orders. You may not be able to get to your trading platform quickly enough. Alerts are a nice little extra service, but only orders represent obligations on the part of your broker to take an action in the market for your account.

Every trade strategy needs to consider upcoming news and data events before the position is opened. Do your homework. You may then decide whether to increase your take-profit objective depending on the market's reaction to the news. If the GDP comes in unexpectedly high, the fundamental basis for your trade is seriously undermined and serves as a clue to exit the trade earlier than originally planned.

Do not hang on until the bitter end if your trade rationale has already been shown to be wrong. The reason you are in the trade is no longer valid. You are wrong – get out. You may even consider reversing your position considering the new data. Speculating based on an expected event or data outcomes is perfectly valid. It becomes a problem only if you maintain the trade even after the data/event outcome has come out against your expectations and strategy. Always relate incoming news and data back to the original reason for your trade, and be prepared to change your trade strategy accordingly.

"When my information changes, I change my mind. What do you do?" – This wise statement is attributed to the economist John Maynard Keynes

Securities function alongside other major financial markets, such as stocks, bonds, and commodities. Some securities are driven by other securities – the dollar/gold, Oil/gas, Soy/soy oil. Although these financial markets overlap to some degree, there are few reliable correlations and consistent between currencies and other markets on a short-term basis. This is particularly true in recent years. There is a strong persistence in markets these days to correlate – go up and down together.

But there are still important fundamental and psychological relationships between other markets and currencies, especially the U.S. dollar. Occasionally one market becomes temporarily highly correlated with another – for example the S&P and Crude Oil may move in step, tick by tick, for a while until their own fundamentals drive them apart. We look to developments in other financial markets to see whether they confirm or contradict price moves in our security. So even though there may not be a statistically reliable basis on which to trade securities based on movements in other financial markets, you'll be a step ahead if you keep an eye on the following other markets. Sometimes a shock in one market will have repercussions in another, somewhat unrelated market.   - A rate increase coming in higher than expected may be suddenly bad for copper.

Government bond yields are a good indicator of the overall direction of interest rates and expectations; the US yields, in particular.

Rising US yields tend to be dollar positive, and falling yields tend to be negative for the dollar. If yields are rising, but the dollar isn't, it suggests that other factors are at work keeping the dollar down and that dollar bulls should be cautious. If yields are falling and the dollar is falling, too, you're getting confirmation from the bond market of a negative U.S. dollar environment — lower interest rates.

Make sure you understand the reason for the bond yield's movements, because it can suggest different interpretations. For example, If it's based on interest rate expectations — due to data or Fed comments, it's more likely to reflect overall dollar direction. If it's due to market uncertainty and a flight to quality — due to emerging market fears, for example — the impact on the U.S. dollar is less certain. The larger the change in yields, the more important is the message that's coming from the bond market. Any yield changes of more than 3 to 4 basis points should get your attention.

Gold is typically viewed as an alternative currency to the U.S. dollar as well as a hedge against inflation and a safe-haven investment in times of geopolitical uncertainty.

As such, gold prices tend to move in the opposite direction to the dollar but there is little short term correlation., There is very little correlation, long term or short term, between stock markets and currencies. The currency markets tend to lead gold and not the other way around due to illiquidity in the gold market.

But in certain cases, where stock market movements are especially extreme, such as a multi-percent daily rise or fall, the currency of the domestic stock market is likely to experience a knock-on effect.

For example, if the Japanese Nikkei stock index rises or falls by 1 percent, the yen is unlikely to react one way or the other. But if the Nikkei drops by 2 percent to 5 percent in a session, so the yen is going to come under selling pressure as investors sell Yen assets and repatriate dollars. It's all a matter of degree.

At certain times the oil price can drive the stock and currency markets

We have seen occasions when the stock markets and oil price have correlated at +1 – a one percent move in oil being matched by a one point move in the Dow. This is not normal but happens when the market becomes fixated with an oil theme.

And that concludes Module 1. In the next module, we will explore how to update your trade plan over time.

Module 2

Welcome to module 2

If you're like most traders, after you enter a position you're going to be watching every pip or point change in prices. Every little price change, and the swings in your unrealized profit and loss (P&L), will cause emotions ranging from joy to despair, heart racing to stomach ache. It is natural. After all, in the end, it's the P&L that matters, and dollars are how that's measured.

But one element that tends to receive remarkably little attention from traders, at least on a conscious level, is the passage of time. Prices may seem to stand still for extended periods — when a currency pair may be stuck in a range (that is, it keeps trading back and forth over the same ground) — but time is constantly moving forward. Staying aware of time and its passing is an important skill for traders to develop. You know where the market price is now, so the question is really: Where will the market price be in the future?

As time moves forward it brings in regular, sometimes price moving events, such as daily or weekly closes, weekends, options expirations. These are times when increases in volatility are normal. Time also brings us nearer to scheduled news and data events and pricing in of market expectations for the events. Price movements in anticipation of news is an external feature and can sometimes be significant although it reflects news that has not, and may never, happen.

This anticipation price movement may be in or against the direction of the trend driven by the longer-term fundamentals. For this reason, breaks of trend lines and other chart breakouts are often false. The market is noisy.

For example, if your trading strategies includes trend-line analysis, you need to be aware that price levels derived from trend lines will change depending on the slope or angle of the line. The steeper the slope of the line, the more the price level changes over time; the less the slope, the more gradually the price levels will change with time.

Here the S&P establishes and uptrend

The S&P breaks the uptrend but just briefly. The uptrend reasserts very strongly but at a slightly less acute angle.

The S&P breaks the long uptrend but, once again, the break is brief and false and we are on our way up again

The S&P has been in a clear uptrend since the 2009 low. Wasn’t it? It was easy with the benefit of hindsight and after redrawing the uptrend line over time.

This 10-minute chart of the euro gives you a good idea of how short-term price levels based on a trend line will shift over the course of just a few hours. Note how steeply the trend line is sloping downwards. For prices to continue to move lower in line with this trend line, they must stay below the trend line as it falls over time, suggesting a price decline of around 18 pips per hour will be needed for the trend to hold.

It does not matter what timeframe you are using, a 10-minute chart or a weekly bar chart, be sure to factor in changing levels of trend lines if they are part of your strategy. You need to adjust your order, possibly stops, accordingly to follow the price.

If you choose to consider where trend line support and resistance will be over the period ahead of you while the market is open and trading and you may not be able to give it your attention. Consider using a trailing stop technique such as Parabolic SAR, Moving Average, Chandelier stop or simply set number of pips or points reversal.

If you are entering the market using a trend line you will need to adjust the limit order over time. You may miss a trade if you do not and, worse, if you have left your order languishing and it is touched, it means you are buying when the market has already broken down through the trend line.

Big and important trend lines which were a long way away a week or an hour ago, may be suddenly right on top of you.

If the pivot support level is below the price and holds , then you should use a limit-entry buy order. If it is above, a limit entry sell order.

Also, significant pivot points which were far away a short time ago may quickly come right into play. Ensure you are aware of big levels outside your normal frame of focus – see the wood for the trees. When pivot resistance and support levels break, we can have technical breakouts. These can be very powerful and sometimes initiate big follow-through moves.

And that concludes Module 2.

Module 3

Welcome to Module 3 in which we explore how important it is to close out trades to maximise results.

By looking ahead for future news and data announcement and changes in technical levels which are expected during the life of your trade, you will reduce the likelihood of trade upsets. More importantly you will be able to recognise events which are not expected or where the market *moves the wrong way* to news. <u>Time to act!</u>

If you are in a trade on the basis of some expectation of news having a certain price result – say bullish or bearish for GDP – and the market does what is expected <u>before the release</u> and you are already getting the lower dollar you hoped for, you may look to secure some profits before the announcement itself. Why not wait for the news and feel the full benefit. Well, there are three possible outcomes:

> If the data comes out negative for the dollar and the market sells the dollar in response, you still have a part position and will benefit.
>
> The data comes out stronger than expected and the market (and you) are positioned wrongly and you and everyone else is forced to scramble to cover. Your good trade has turned very bad.

> Sometimes the news comes out in line and is priced in. It can be a disappointment and, with many short- term traders positioned short of the dollar for the news there are only short-coverers around and the price may go up despite the disappointing news. As traders say, <u>“sell the rumour, buy the fact”.</u>

In most outcomes, you are better for taking a part profit. The financial world is a fast changing one. <u>Be Prepared! Plan!</u>

Before major data and news events, the market also frequently goes into a narrow sideways pattern. The event traders have all put on their positions, and the rest of the market is side-lined, waiting for the data before reacting to it. These *consolidations* can develop hours or even days in advance, depending on the upcoming event. This is especially important if you're trading from a short-term perspective, be prepared for these doldrums and consider whether riding through them even is worthwhile. After all, even sideways movements are a risk to your position. Anything can happen while you have the position for the news and you are still waiting for it.

Just because you've got a well-developed and considered trade plan doesn't mean it absolutely must be carved in stone (apart from the initial stop-loss exit which must be carved in stone.) When you are in a position, and the market is moving for you, it's important to be flexible in amending stop-loss orders to protect your profits and even in adjusting take-profit targets.

<u>Make this rule</u>, never adjust your take-profit targets without also adjusting your stop-loss order in the same direction at the same time. If you're long, and you raise your take profit, raise your stop loss as well. If you're short, and you lower your take profit, lower your stop-loss order too.

<u>What are legitimate reasons to move your target forward?</u> Look for any of the following events to consider making this change to your plan:

There are two types of shocks in the market, expected ones and random ones. <u>Most shocks are expected shocks</u>. How can this be? A surprising Non-Farm Payroll figure may well be a shock but it is not a shock that it happened. We knew exactly when it would come. – at 1.30 UK time on the third Friday of the month – each month. It may be a shocking number. But it is not a shock that it was released. This was an expected shock.

In contrast, there are other types of shocks – true shocks: assassinations, profit warnings, shock announcements or comments from central bankers. These are essentially random and truly unpredictable.

But in reality most shocks are expected. Even weather shocks. It is shocking when rigs are blown off their moorings in the Gulf of Mexico but the hurricane season is not a shock. It happens at the same time each year. Likewise, droughts or floods. They can be shocks but it is not a surprise that summer or winter arrives. Genuine surprising shocks are relatively few in number. <u>Most shocks can be called *expected surprises*.</u>

How the market takes surprises varies. Sometimes it absorbs the price shocks. The shock may have been expected and discounted. Sometimes the moves can be unusually extreme aided by reduced liquidity which is most evident during public holidays, seasonal periods (late summer, Christmas/New Year's), end of month, end of quarter, and certain Fridays and even lunchtime.
If the news breaks a major technical level - a Trend line dating back several months or years,
a Fibonacci retracement level of major recent directional moves, or a recent extreme highs or lows - then we can expect the news to trigger larger-than-normal price movements. Reduced volatility preceding the breakout is another ingredient in favour of a more sustained directional move.

The more illiquid and volatile the security you're trading, the greater the chances for an extreme move. In currencies, GBP, CHF, and JPY are the most common culprits among the majors. As you can see, the list is short, and there may be only a ten or so events in the course of a year that warrant altering your trade plan. Stay disciplined.

As we have discussed we are reluctant to increase our profit objectives unless there are significant grounds to do so or we have substituted a trailing stop loss. When it comes to protecting our profits, we're much more comfortable about adjusting stop losses to lock in gains. Sometimes we are too keen. When you've got a profit in the market, taking steps to protect it is always a smart move but do not be so aggressive to protect your open profits so that you do not allow the trade to run.

Another way to protect profits is to trail dynamically using a *trailing stop*. There are several ways to trail stops. These are covered elsewhere but they all follow the price movement in some way and hold you in a trade until the price turns and you close out on stop. After a technical level in the direction of your trade is overcome, you may consider instituting a trailing stop to replace your fixed stop-loss order. Set the trailing distance to account for the distance between the current market and the other side of the technical break level.

Module 4

Having a trading plan puts you ahead of most of the market. Make sure you have decided your trade size, entry levels and exit levels – both stop loss and profit taking while you can think clearly. It is impossible to think clearly under stress. Think of top footballers messing up penalties – they are working under extreme pressure and are sometimes overwhelmed with the consequences of what they are about to do. They then cannot do something that is relatively easy and they have done without problem a thousand times. But it is different when your head is not clear. Without a moving P&L you can see the picture clearly. Use that time to make your plan. Do not try to plan when your brain is cannot function properly.

How do you know you are a trading genius? When you take a profit. The psychological pressure to take a profit is enormous. We hate to lost open profits. They sometimes feel even worse than straight losses.

Stick to your plan. If you are out, you are out. Many traders are full of regret and try to chase and re-enter the market and get themselves into a mess simply because they did not sell at the high. There is always another day. No trader gets it right 100% of the time.

Similarly avoid the urge to take a position in the opposite direction both when you take your profit or get stopped out. Remember this is an entirely new trade and it needs a fresh new plan.

If you can trade in sufficient size or multiple lots you have a lot of flexibility on your exit. If the price moves in your favour and exceeds the difference between your initial entry price and initial stop, you might consider taking a part profit there. You are now trading for free. You might consider taking part profits a resistance points which you meet before your target. The trade may end disappoint early at this level and never reach your target. At least you have secured some profit on your trade and, after being stopped out of the balance on the reversal, you should have an overall profit on the trade. Don't forget to alter your stop order size if you take part profits.

No one is ever happy when they get stopped out. Even taking a profit on a reversal stop is disappointing at that moment. Being stopped out at a loss and being stopped out at a profit often feels the same – disappointing. A short time later you may well be very glad you had that stop. It was doing its job.

You cannot avoid 'false breaks' and unfortunate stopping out. You can reduce it by placing your stops intelligently. But never attempt to totally eliminate it. If you have eliminated 'false break' stops, your stops are too far away. You are losing too much every time you are stopped and will be worse off overall.

When you have identified a trading opportunity and have made your plan, depending on your trading style, you may be able to set and forget your orders. Using *If Done* and *One Cancels the Other* (OCO) orders, you have the tools to automate your plan.

This is very suitable for medium and long term traders. It allows you to relax. Take on more trades because now you can handle them. But don't forget to use the Alerts function on your system to tell you have to move the stop now a certain price has been reached.

Shorter term day traders are most likely not to rely on placed orders. But they must ensure they realise a stop is a stop and they must do it when the time comes. If they do not have the discipline to do this, they will fail badly.

While you may be flexible in your take-profits order you must be rigid in your stop loss orders. They only move forward and are never cancelled.

If you are trading on the basis of fundamental or news events, realise there is a message when the price does not move in the direction of the news. If you are long because you expect the fundamentals or news to be bullish and they are but the market barely moves BEWARE. The market is telling you, the news you expected was already priced in. Be aware also, if the market is already long and there is no one left to buy when the good news comes out, you have a market full of potential sellers. Tighten your stop right up.

There may be times you do not want to be in the market. Maybe you are day trading and there is a big figure due and the market is expected to be volatile. You must square off in front of this figure. If you do not, you are just gambling and you will go the way of the gambler. You cannot rely on your stop to protect you in these circumstances. The slippage (the bad execution) is likely to be great and completely ruin your risk/reward ratio.

Other times to be aware of are the openings, especially the London FX opening. You get high volatility from 07.00 London time until about 09.00 every day. Things usually go quiet then until the US opening.

Market closes are often also a volatile time. Mondays and Fridays are often trend days and Tuesday until Thursday are often quieter and counter-trend days. Fridays can be very busy or dead. Pre-holidays can also be quiet are traders head for the beach before the long week end. Month and Quarter ends can be very volatile – especially triple witching Fridays.

The price tells you everything. It is the product of all the fundamentals, news and (most importantly) how the market interprets the news. Remember the market price rarely goes in a straight line. It zig zags in response to supply and demand. Pull backs are part of the process of going up. If you are still making higher lows you are still going up. Your strategy and plan should allow for this if you are a medium or long term trader. If you are a short-term trader you will probably only look to participate in the impulse moves, the zigs and be out for the reactions – the zags.

In summary,…..In this video we have discussed:

- Staying on top of the news and the markets
- What are other markets telling you?
- Updating you trading plan during a trade
- Protecting profits and letting them run

Thank you for watching and listening. If you have any questions about anything we have covered, please do send me a question via the Institutional Trader Programme platform or ask your online course tutor during the course of your three-month online programme. Thank you for listening.