

TRADING LIFE

Travis McKenzie shares his trading life.

I think every trader has a number of 'aha' moments that are instrumental in their development as a trader. In this article, I will pass on a few of mine.

Like many traders, I learnt to trade by reading books, attending seminars and scouring the internet.

After approximately four years I had acquired sufficient knowledge – I realised there was little more I needed to learn. I could talk for hours on almost every facet of technical analysis, but, sadly and very frustratingly, I was still losing money.

To use the analogy of baking a chocolate cake: my first 'aha' moment came when I realised I knew all the ingredients but I didn't have the recipe for baking a chocolate cake. I knew all about flour, eggs, cocoa, and so on, but I had no idea about how much of each I should be using, in what order I should be mixing them, or, most importantly, how hot the oven should be. Every time I read another book or attended another course I simply learnt more and more ingredients – but still did not have a recipe.

In 2004 I met Nick McDonald (now my business partner). We started trading together daily and have done so ever since. Over a number of years, Nick and I began to develop our own trading strategies (recipes) based on the technical analysis (ingredients) we knew so well. We had to choose the ingredients that were working best for us (e.g. price action) and to decide which were not working and could be ignored (e.g. most indicators). We wrote out our strategies just like writing out a recipe. We developed checklists and a scoring system for each of our strategies. (These days, every one of our trades must meet the checklist's requirements and must obtain a minimum score before we even consider taking the trade.)

During the development process we realised we had been relying on too few ingredients to 'bake our chocolate cakes'. This is a common mistake, made by many beginning traders. Most losing traders look for just one technical

factor before entering a trade; intermediate traders might look for three or four technical factors to be aligned. The strategies that we now trade and teach require at least eight technical factors to be aligned.

My next 'aha' moment came when I realised that no strategy will win on every single trade, no matter how perfect the set up. Over a large sample of trades, you can work out your strategy's win to loss ratio. For example, if, over the course of 100 trades your strategy won 70 and lost 30, that strategy has a 70 per cent win to loss ratio. But from one trade to the next you have absolutely no way of telling whether a trade will win or lose.

With a 70 per cent win to loss ratio you know there is a very reasonable probability that over the next 100 trades you will have 70 winners and 30 losers. However, what you don't know is the order in which those winners and losers will occur. Statistically, you could have 20 losing trades in a row, although the odds of this occurring are very low.

What normally happens after a large losing streak is that traders believe their strategy is no longer viable. They cease trading it or tinker with it to try to improve it. In reality it might be just a normal losing streak.

I now ignore whether a trade makes or loses money; instead I focus solely on whether I flawlessly execute my checklist and scoring system (trading plan). I then assess my profit and loss over results from a large sample and not by individual trades.

One simple method is to take a screenshot of what the charts looked like when you placed your entry orders. At the end of the week or month, when the pressure is off, you can objectively review whether you executed your trading plan without error. I know that if I flawlessly execute my strategy over a large number of trades I usually achieve very close to my strategy's expected win to loss ratio. So a five-trade losing streak does not bother me, provided I have executed my strategy without error.

The final 'aha' moment came in overcoming

the pressure to trade frequently. I have always focused on risk management and have never risked more than 1 per cent of my account on any single trade. I always aim to make at least 1 per cent from a trade. If I had \$10,000 in my account, the most I could lose on a trade was \$100 – and I would aim to make a minimum of \$100.

Risking so little on each trade kept me from blowing up accounts, but it led me to believe I would have to trade often to make a full-time income from trading. Doing so, of course, caused me to over trade.

One day I calculated that, based on my risk parameters (risking one per cent of my account per trade and having a risk to reward ratio of at least one:one), if I was able to find just one winning trade a week I could make more than 50 per cent a year (even more if I applied compounding). To put that in perspective, Warren Buffett averages approximately 22 per cent a year – and he is among the wealthiest men on earth.

Of course, that is a hugely oversimplified example. It doesn't take into account that you will have losing weeks, break-even weeks and even weeks that make more than 1 per cent. But that wasn't the point of the exercise. The point was that it made me realise that, with sound risk management, I did not need to overtrade to make exceptional returns. I had to focus on quality, not quantity. This realisation took the pressure off and stopped me overtrading, almost at once.

I encourage you to spend time thinking about my 'aha' moments and how they could apply to your trading. I know they helped me turn a corner in my trading journey. They might do the same for you. **VT**

Travis McKenzie is the Head of Online Trading at Trade With Precision. He has 13 years' experience trading a wide range of markets. For more information about Trade With Precision's strategies and courses see www.tradewithprecision.com.au.

