TRADE EMPOWERED
LIVE YOUR PASSION

Presents

Introduction to Trading

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Preface

It’s important to understand that the concepts that we will cover in this chapter are a “boiled down” or summarized version of much larger subjects. The proactive trader must investigate and research these subjects in detail as they will empower and enlighten with more study. This chapter is condensed to serve as a primer for newer traders.

One Step at a Time

Regardless of what financial instrument you will eventually trade, the most important thing is learning what to do and what not to do….

…and WHEN and WHEN NOT to.

The purpose of this book is to teach you the basics of trading and how to make an informed decision on the best way to trade.

We will cover all the basics that most people are too afraid to ask for fear of appearing silly. We will get into some advanced stuff later but we will take it one step at a time.

Very Important: This book is for educational purposes only. I am not suggesting or implying anywhere in the book that you should rush out and invest your hard earned money in the financial markets. In fact I will teach you how to trade on paper without risking any of your hard-earned money first.

Never! Never! Never! Put money into anything you don't fully understand. This is where this book comes in. All the basics concepts about approaching trading with the right expectations are included in the following chapters.

What to Expect in Trading

As the name implies this book is designed for new and novice traders. It has also however become a reference point for many experienced traders. The concepts contained in the pages that follow can just as easily be adapted for the professional trader as well as the novice trader.

My hope is to guide new traders through the misguided expectations that some folks in the trading industry set and leave you infinitely more informed and better equipped to trade just about any market.

You are reading this book for one of 3 reasons. Either you are (1) A new trader (2) a trader unsatisfied with your results, or (3) a trader that wants to improve upon what's already working. No matter what your experience know that the scope of this book is fairly large and is intended for trading in general as opposed to a particular market segment.

New traders often are unsure of not only the best market to trade, but are also unaware of the variety of markets that can be traded.

The Reality

If you are new to trading then I am glad you started with this book because there are a lot of misconceptions out there.

- ✓ The first question I would like you to ask yourself is why you decided that you wanted to trade in the first place?
- ✓ Was it the dream of working at home and earning loads of money?
- ✓ Was it the thought that you could beat the markets?
- ✓ Was it the images of what you have seen on T.V and the excitement of trading?

I ask these questions because for the vast majority of professional traders life is nothing like what it is perceived to be.

The early stages of your trading career can be frustrating and financially unrewarding. However, those how put the work into it, like anything in life, can be very rewarding.

Before we go any further we are going to be 100% honest with you and tell you the following before you consider trading any market:

- All traders, and we mean **all traders LOSE money on trades.** So, if you hate to lose or are a super perfectionist, you'll probably have a hard time adjusting to trading.
- Trading is not for the unemployed, those on low incomes, or who can't afford to pay their electricity bill or afford to eat. You should have at least $10,000 of trading capital (in a mini account) that you can afford to lose. Don't expect to start an account with a few hundred dollars or a few thousand and expect to become a billionaire.

You would think traders all over the world would make a killing, but success has been limited to very small percentage of traders.

Many traders come with the misguided hope of making a gazillion bucks, but in reality, lack the discipline required for trading. Most people usually lack the discipline to stick to a diet or to go to the gym three times a week.

If you can't even do that, how do you think you're going to succeed trading?

Short term trading IS NOT for those who are not prepared to do the work, and it is rarely the path to “get rich quick”. You can't make gigantic profits without taking gigantic risks. A trading strategy that involves taking a massive degree of risk means suffering inconsistent trading performance and often suffering large loss.

Trading is a SKILL that takes TIME to learn.

Skilled traders can and do make money in this field. However, like any other occupation or career, success doesn’t just happen overnight.

Trading isn’t a piece of cake (as some people would like you to believe). Think about it, if it was, everyone trading would already be millionaires. The truth is that even expert traders with years of experience still encounter periodic losses.

Drill this in your subconscious: there are NO shortcuts to trading. It takes lots and lots of TIME to master.

There is no substitute for hard work and diligence.

Master one Signal

REMEMBER

In the beginning, concentrate on ONE trading signal.

It gets far too complicated to keep tabs on more than one market when you first start trading. Stick with one of the majors because they are the most liquid. (More on liquidity later)

You can be a winner at currency trading, but as in all other aspects of life, it will take hard work, dedication, a little luck, a lot of common sense, and a whole lot of good judgment.

Do NOT open a live trading account until you are trading PROFITABLY on a demo account. (More on this later)

If you can't wait until you're profitable on a demo account, at least demo trade for 2 months. Hey, at least you were able to hold off losing all your money for two months right? If you can't hold out for 2 months, cut your hands off.

90% of Traders Go Bust

Believe me when I tell you that 90% is a conservative estimate. Some sources have it as high as 99% of traders losing their initial starting capital and I have also read that not only do over 90% of them lose their money but also 10% actually go bankrupt.

Why is it that so many traders fail? It is not because they are stupid. In fact statistics show that the majority of traders are well educated, have above average incomes and are generally highly motivated.

Ninety percent of traders lose money, largely due to lack of planning and training and having poor money management rules.

So why do so many fail?

Lack of Trading Education

By education, I don't just mean learning how RSI works or drawing lines on a chart. I mean thoroughly educating yourself in all aspects of your chosen profession.

- ✓ Educating yourself on the correct psychological approach to the market!
- ✓ Educating yourself in the correct money management techniques relative to your account size.
- ✓ Educating yourself in the correct entry and exit methods for the trading style that suits you.

This is where I hope to be of some help. I don't have all the answers nor do I profess to be some kind of guru, but I know that the methods that we teach are the same methods that traders have used to take BILLIONS out of the market.

If you need proof, look no further than Jack Schwager's Market Wizards and New Market Wizards where you read 36 interviews from 36 traders, all of whom have been wildly successful in the markets, not due to luck, but do to their ability to remain consistent through the years through study, mind management, and practice. NOT ONE of them attributed their success to a 'magic indicator or trading system' but instead to BELIEF in YOUR trading model, the DISCIPLINE to follow it and the use of proper position sizing to manage risk.

The Learning Never Ends.

As with any profession, whether you're a doctor, lawyer, athlete, assassin, spy, ninja, ultimate fighter, musician or any other occupation that requires a high level of skill, you can never stop learning and practicing. Otherwise, your skills will deteriorate and you'll slowly forget what you've learned.

This lesson will give you a peek into what it takes – education, time, money and psychological stamina – to enter the most financially rewarding career on the planet: a professional trader.

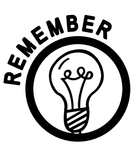
Imagine yourself in a legal situation and you decide to hire the cheapest lawyer you can find. On the day you have to stand in front of a jury, your lawyer says to you, "Don't worry, while this is my first time, I've read 'How to be an Awesome Lawyer in 28 Days for Idiots' a couple of times, so I know what I'm doing. You'll be fine."

Do you think your investment in that lawyer will pay off?

Probably not.

Now I'm not a professional lawyer, but I'm pretty sure that it takes more than one book to become one. More likely, lawyers have read and studied a wide range of books, journals and case studies in order to fine-tune their practice.

So why should it be any different to become a professional trader?



Trading involves becoming proficient in a multitude of disciplines, including fundamental analysis, technical analysis and managing your Trading State (Also known as Trading Psychology – we go into a whole extra book on Psychology of trading).

Within those disciplines are different topics that should be studied individually.

For instance, while later chapters of this library does a fantastic job of introducing the Money Management principles and making it easy to understand, there's abundant amount of entire books written on that single subject. The same thing goes with many other technical tools (i.e. candlestick charting, Fibonacci numbers, pivot points, etc.), fundamentals and trading psychology.

If you limit your education to a basic high-level overview of a few subjects, how do you think that will help you acquire the skills needed to become a successful trader?

I'm not saying go out there and read everything there is to read on trading. While that seen ideal, realistically it's not possible, and **it becomes conflicting.**

Trading as a Business

Have you ever told yourself there's never enough time in the day? I think we've all thought that to ourselves at one point, but if you're not willing to shift your priorities to make time for trading, and then forget about becoming a trader.

Contrary to popular belief, trading is not a hobby.

Trading is not a hobby.

Golf is my hobby. I pay to play golf. Golf is Tiger Wood's business. Tiger Woods is paid to play golf.

See the difference?

You have to devote yourself to trading just like you would with any other business in order to be successful.

So, it's time (pun intended) to ask yourself this: "Can I balance my time and change my lifestyle to make room for trading?"

I'd better hear a resounding "YES!"

But before you can even truly answer that question, you need to first figure out what your daily priorities are and determine whether or not you can make trading THE number one priority.

We all want to be wildly profitable, and initially we may drop everything else to get there, but in the end an unbalanced life will lead to personal and/or professional failure.

Startup

It takes money to make money. Everyone knows that, but how much does one need to get started in trading? The answer largely depends on how you are going to approach your new start-up business.

REMEMBER

- **First,** consider how you are going to be educated. There are many different approaches in learning how to trade: classes, mentors, on your own, or any combination of the three.

  While there are many classes and mentors out there willing to teach trading, most will charge a fee. The benefit of this route is that a well-taught class or great mentor can significantly shorten your learning curve and get you on your way to profitability in a much shorter amount of time compared to doing everything yourself.

  As long as you are disciplined and laser focused on learning the markets, your chances of success increase exponentially. You have to be a gung ho student. If not, you'll end up in the poor house.

- **Second,** you are going to require special tools such as charting software.

  As a technical trader, most of the charting packages that come with your broker's trading platform are sufficient (and some are actually quite good). For those who need special indicators or better functionality, higher end charting software can start at around $100 per month.

- **Finally,** you need money/capital/funds to trade. How much exactly? Well, let's be honest here. It's common knowledge that most businesses fail due to undercapitalization, which is especially true in the trading business. So, if you are unable to start with a large amount that you can afford to lose, be patient, save up and learn to trade the right way until you are financially ready.

Common Misconceptions

- ✓ They think they can trade consistently with 80% accuracy.
- ✓ They think they can turn $1000 into $100,000 in six months.
- ✓ They think they can predict turning points in their given market within minutes.
- ✓ They think they can buy a system that is 100% accurate.
- ✓ They think they will quit their jobs and make a living full time after a few months of trading.

What's the reason that so many new traders believe that trading is an easy way to make money? **Propaganda!**

We are continually bombarded in magazines, emails and the general media by claims of making astronomical amounts of money by just applying the vendor's latest method or system.

Fundamentals of Trading

Trading is not an exact science. You can't do X and get Y every time. It is as much an art as it is anything else. However, it's an art based on science in our experience. The science stems from the ability to follow rules. No different than the rules of driving a car or building a house. Those rules followed with precision will achieve the desired result. **However we have found one truth to be 100% true…**

There is no perfect self-working formula.

However, there is a solution. Your trading mind.

REMEMBER

Trading is all about probability. It is the art of correctly applying a set of carefully thought out rules and allocating the probability of that event to result in success.

Study these 3 points close as they are the winning expectations of any trader:

- ✓ Each trade is an independent event. The market does not remember if you lost or made money the last time you traded.
- ✓ The way you approach the market psychologically has as much to do with your success as any trading plan.
- ✓ Money management is crucial if you want to have any hope of becoming a successful trader.

Matching a method of trading with your personality is the only way you will ever feel comfortable in the markets.

An adequately funded account is necessary not only to be able to take the trades you want, but also so you don't feel every trade is a live or die situation.

REMEMBER

The journey to the road of successful trading will make you confront your deepest fears. Your armor on this journey will be confidence, knowledge and believing that you can achieve your dreams

Never, never equate your success or failure in the markets with who you are as a person!

The Flaw in Our Emotions

As humans we have a natural tendency to try and influence our surroundings and events we take part in. This is one reason as a species we have succeeded but it is also one of the fundamental flaws we all have when trying to achieve success as a trader.

As traders we have to realize we have no control over the market and if we accept that then we have to accept that we can not influence the direction of the market.

The problem of course is we have a tendency to try and succeed and when inevitable losses come it is easy to let those losses effect us emotionally.

Becoming euphoric when you hit a winning streak is almost as detrimental as becoming depressed when you have a string of losses.

We traders have to try to achieve a state of impartiality. We have to accept that we will have losses as readily as we will gains.

Reaching a stage where you can comfortably accept losses, in the knowledge that your method of trading will produce profits in the longer term, is the state we have to aspire to.

Many, as I did, paid tens of thousands of dollars for courses only to find out that the method they paid for didn't focus on the true success element, **my psychology.** (More on Trading Psychology later)

Trading is not an exact science

No matter what anyone tells you, trading is not, nor has it ever been, an exact science. An art based on science? It seems to be so…

To date there has never been an institution or individual who can guarantee you will beat the market every time you trade.

Just think about it, if anyone one had an exact method that always won, they would have all the money in the world, given enough time.

Long Term Capital (LTC) tried to corner the "No Risk" theory some years back and came close, but we saw what the outcome of that was.

(Google search LTC)

Big institutions with all their expertise still only chug out 10% a year in a good year.

Am I saying that you can't make money in the markets?

Absolutely not.

You can make money in the markets and quite often a lot more than the institutions.

As I said at the beginning of the book, I am trying to give you an overview of trading, **the pros and the cons.**

Here's the good news! **Once mastered trading can be a rewarding profession both financially and emotionally**. It can give the financial independence to never work for a boss again and you will learn a lot about yourself as a person on the way to becoming a trader.

Investor or Speculator?

Even though you think you want to learn how to trade it is a good exercise to ask yourself if you are really an investor or speculator.

Investor

An investor is someone who buys something in the belief that over the long term the security (any investment vehicle that can be traded), whatever it may be, will go up in value.

Their period of time may be months, years or even decades. They will be quite happy to own a security for a longer time period because they believe in what they have just bought or have researched the security and are happy that it will increase in value in the long term.

An example of an investor is **Warren Buffet**, one of the most successful investors of all time.

Speculator

A speculator is someone who buys or sells something with no directional bias.

He has no loyalty to the thing he is buying or selling and will typically own something from 1 minute to a few days or even weeks.

An intraday trader may buy and sell a security a hundred times in both directions in the same day. An example of a speculator might be someone like **Richard Dennis**.

Who Trades the Markets?

Let's just clarify what is meant by the term trader, sometimes called retail trader or day trader.

Traders come in many different shapes and sizes. There are male traders, female traders, fat traders, skinny traders, traders who climb on rocks, tough traders, sissy traders, even traders with chicken pox. … and the list goes on.

Each trader has their own personality, their own personal schedule, their own appetite for risk, their own pain threshold and their own bankroll.

Some traders might have several things in common, but most will be different.

REMEMBER

The point is that each of you are unique. And depending on your personality, personal preferences, and situation, how you trade will be a driving factor in determining your success.

In order to figure out how you should trade, you must first uncover your own "trading personality." Your trading personality will determine the trading style and method that's compatible for you.

There is no single plan for all traders. There is a Trading Plan Template, a set of GUIDELINES that all traders can use to guide.

I challenge you to perform a self-assessment on your personality, behaviors, beliefs, and mindset.

- Do you consider yourself disciplined?
- Are you risk averse or a big risk taker?
- Are you indecisive or spontaneous?
- Are you patient or a firecracker?
- Would you prefer to go bungee jumping or visit a museum?
- Do you like your martini shaken or stirred?

You will only ever be successful as a trader if you rely on your own judgment to trade. At the end of the day it's your money.

Trading Journal

An excellent way to help you with your self-assessment is to keep a trading journal. (More on Trading Journals later) It will help you to analyze your thought processes after the trade, and identify your strengths and weaknesses in your trading.

Understanding your personality is one thing, but understanding it while you trade is a totally different story. A trading journal allows you to review your winning and losing trades and pinpoint specific reasons on why you won or lose.

So, what kind of trader are you?

Well, one of the first questions to ask is, "how much time do I have to trade and how long can I comfortably be in a position?"

We can identify different trading personalities by timeframe. Take a look at these different styles and see which one may fit you.

- ✓ **Scalping** – Scalpers are very short-term traders, usually in and out of trades within seconds.
- ✓ **Day traders** – Day traders open and close positions in the same trading session.
- ✓ **Swing traders** – Swing trading holds trades for hours or days.
- ✓ **Position trading** – Long term position traders hold trades from weeks to months at a time.

Are you a system trader, or are you a discretionary trader?

- ✓ **System Trader** – a system trader or mechanical trader tends to take to signals from system of technical indicators to automatically enter and exit trades. For instance, if the stochastic indicator shows that the market is oversold, the system trader will automatically enter a buy.

- ✓ **Discretionary trader** – this trading style usually refers to traders who use both technical and fundamental analysis. A trader's technical method may signal a possible trade entry, but his or her analysis of the fundamental landscape may show a different story on the same market.

Succeeding in trading takes hard work, lots of time, and some blood, sweat and tears. New traders need to be realistic right from the start. Beginners should start small and constantly evaluate their profitable trades as well as their failures.

TIP

Like I said earlier, trading is not like buying a t-shirt. One size does not fit all. Before you can succeed in trading, you must spend time doing homework, learning your personal strengths and weaknesses, and assessing your personal schedule, trading capital and trading experience.

Take the time to answer these questions, and also look back at your trading journal to see how you fared in different trading situations. Only then will you be able to decide on a trading personality that's compatible for you.

Traders come from all walks of life, everything from company directors to bricklayers. Some trade full time and others trade part time whilst holding down full time jobs.

What people trade?

In today's information technology driven economy you can just about trade anything you want. Whether it is currencies, metals, shares, wheat, pork bellies you name it.

Not only can you trade the main security but also in most cases you can trade the derivative of it e.g. Forwards, Futures and Options.

All financial instruments are commonly referred to as securities regardless of their name. When I mention securities it encompasses everything that can be traded.

The main thing to remember when trading, is first to decide if you are a speculator or investor.

If you are an investor it makes sense for you to know something about the thing you are investing in. It might be that you are in that field already or have a good knowledge base of what you are investing in.

On the other hand if you are a speculator who only intends to hold something for a few hours and are covering many markets, you will not have time to research as much as an investor. Market focus will be critical.

Commonly Traded Markets

Stocks

When you buy stocks you essentially own a little share of the company you just bought. The more shares you buy the more of the company you own.

When the company whose shares you have bought makes a profit you will receive that profit in the form of dividends.

Ownership of shares is normally called equity.

REMEMBER

There are two main types of stocks. Preferred stock which normally pays regular dividends and common stock which often gives you more rights than preferred stock. Which one you chose will, depend on what you are trying to achieve.

To buy stocks you normally need to have an account with a broker. The type of broker you will need depends on what type of service you require from the broker.

If you want to have full access to reports on particular shares and be able to ask for advice from the broker, then you would normally opt for a full service broker.

If you are independently minded and don't require recommendations or reports and only wish the broker to execute your orders, then you would opt for a discount broker.

Opening an account with a broker is similar to opening an account with a bank. You will be asked for personal information and given forms to fill in.

Where Are Stocks Traded?

The most common place for a stock to be traded is in a stock exchange. Stock exchanges are physical locations where market participants are brought together in once place.

The most famous of the exchanges is of course the New York Stock Exchange where an estimated $12 trillion changes hands each year.

Futures

REMEMBER

Futures are normally traded in contracts and are a legally binding agreement between a buyer and a seller.

The seller must deliver the specific agreed upon asset at a future date but for the price agreed today. (Technically)

Futures markets allow companies and individuals to protect themselves against fluctuations in the price of an asset that they are interested in. This allows them to sell an asset in advance giving them the ability to make plans for the future in the knowledge that they have a fixed price.

History Lesson:

Futures have been with us for a long time. The first use of futures can be traced back to 1650's during the Tokugawa era in Japan.

Feudal lords used to collect rents from their tenants in the form of rice.

Not only would they trade the rice that they had collected but also, they would often trade their future rice delivery.

This was the start of what became the Dojima Rice Market. Even today rice futures can be traded but the range of the market has expanded to include many other things.

For new traders the word future can be confusing as the word implies that everything takes place in the future. What actually happens is that the settlement takes place in the future but the price is agreed upon on that day (today).

REMEMBER

It also important to realize when trading futures that just because you bought it does not mean that you have to keep it until settlement. You can sell the contract long before delivery of the contract is due.

Like many other markets you also do not need to necessarily own the asset before you sell it.

You can sell a futures contract just as easily as you can buy it.

Because futures have been around for such a long time nearly all markets around the world that trade in futures are highly regulated. The fundamental principle of a future is fairly simple. You buy or sell something at today's price for delivery in a future date. This can prove to be extremely valuable to farmers and organizations to protect themselves against future fluctuations in price.

For Example:

Let's use a farmer for example. This allows him to sell his crop before it is harvested. In times when the harvest is plentiful and many other farmers with the same crop have had bumper harvest then there will be an over abundance of that crop. This will generally lead to a lower price.

In times when the harvest is bad and other farmers are also experiencing bad harvests the price will be high, as there is a limited supply of the asset.

There will however be times when it is very difficult to know when a crop will be good or bad and for the farmer this can be devastating in planning his future. One way he can overcome this is by selling his crop on the futures market at a price agreed upon today but only for deliver in the future.

If he agrees on a price today and there is a very short supply of that crop on the agreed delivery date then the farmer may very well have been better waiting to deliver his crop at the market price. What the futures does is take the uncertainty of the process away?

Futures contracts are generally divided into to distinct groups:

- ✓ Financial assets such as a group of stocks, a market index or bonds.
- ✓ Commodity asset such as coffee beans, wheat and pork bellies.

Why Would You Trade Futures?

There are three main reasons for trading futures and they are:

- ✓ **Speculation** - Many traders trade the futures market solely for the purpose of speculation. They have no intention of taking delivery of any asset but merely wish to speculate on the direction of the market.
- ✓ **Arbitrage** – Is simply trying to make a profit by exploiting the difference in two different markets. If for example you though that the DJIA futures market was trading to high you might attempt to sell the futures and simultaneously buy the cash market.
- ✓ **Hedging** – Hedging is common in both the commodities and financial assets. If you owned a portfolio of stocks and you thought that the market was about to correct but you still wanted to keep the stock, you might try to sell the market index of where the stocks where listed.

The Difference Between Cash And Futures Prices.

Because of the costs involved with the physical ownership of an asset such as storage and transportation the price between the cash market and the futures market differ. The difference in price is normally called the cost of ownership.

Ownership implies the cash market where you have additional costs, which leads to a difference between the cash price and the futures price where you don't have these costs.

As the delivery date nears, the difference between the cash price and the futures price will narrow and on actual delivery date the two prices will be very similar.

Futures Exchanges

Chicago Board Of Trade (CBOT Established 1848 and founded by 82 Chicago Merchants)

Chicago Mercantile Exchange (CME Established 1919. Originally The Chicago Butter and Egg Board which was founded in 1898which then developed into the CME)

London International Futures and Options Exchange (LIFFE Established 1982 and is now one of the world largest exchanges)

Forex

The word FOREX is derived from Foreign Exchange and is the largest financial market in the world. Forex is often abbreviated to FX.

As the name implies Forex is the exchange of one currency for another at an agreed upon rate.

Unlike many markets the FX market is open 24 hours per day and has an estimated $1.2 Trillion in turnover every day. This tremendous turnover is more than the combined turnover of all the worlds' stock markets on any given day. This tends to lead to a very liquid market and thus a desirable market to trade.

Unlike many other securities the FX market does not have a fixed exchange. It is primarily traded through banks, brokers, dealers, financial institutions and private individuals.

You will however find that most of the brokers and banks use centralized feeds to insure reliability of quote.

It is estimated that anywhere from 70%-90% of the FX market is speculative. In other words the person or institution that bought or sold the currency has no intention of actually taking delivery of the currency. Instead they were solely speculating on the movement of that particular currency.

Currencies are traded in pairs and are each assigned a symbol. For the Japanese Yen it is JPY, for the Pounds Sterling it is GBP, for Euro it is EUR and for the Swiss Frank it is CHF. So, EUR/USD would be Euro-Dollar pair. GBP/USD would be pounds Sterling-Dollar pair and USD/CHF would be Dollar-Swiss Franc pair and so on.

You will always see the USD quoted first with few exceptions such as Pounds Sterling, Euro Dollar, Australia Dollar and New Zealand Dollar. The first currency quoted is called the base currency.

Even though the mighty US dominates many markets most of Spot Forex is still traded through London in Great Britain.

The Main Players In Forex Central Banks And Governments

Policies that are implemented by governments and central banks can play a major roll in the FX market. Central banks can play an important part in controlling the country's money supply to insure financial stability.

Banks

A large part of FX turnover is from banks. Large banks can literally trade billions of dollars daily. This can take the form of a service to their customers or they themselves speculate on the FX market.

Hedge Funds

As we know the FX market can be extremely liquid which is why it can be desirable to trade. Hedge Funds have increasingly allocated portions of their portfolios to speculate on the FX market.

Another advantage Hedge Funds can utilize is a much higher degree of leverage than would typically be found in the equity markets.

Corporate Businesses

The FX market mainstay is that of international trade. Many companies have to import or exports goods to different countries all around the world. Payment for these goods and services may be made and received in different currencies. Many billions of dollars are exchanges daily to facilitate trade. The timing of those transactions can dramatically affect a company's balance sheet. The Man In The Street although you may not think it the man in the street also plays a part in toady's FX world. Every time he goes on holiday overseas he normally needs to purchase that country's currency and again change it back into his own currency once he returns.

Unwittingly he is in fact trading currencies. He may also purchase goods and services whilst overseas and his credit card company has to convert those sales back into his base currency in order to charge him.

We shall differentiate speculator from investors here with the definition that an investor has a much longer time horizon in which he expects his investment to yield a profit as was discussed earlier.

Regardless of the difference both speculators and investors will approach the FX market to exploit the movement in currency pairs. They both will have their reason for believing a particular currency will perform better or worse as the case may be and will buy or sell accordingly.

Options

Options are one of the oldest trading vehicles man has ever used.

Around a 1000 B.C Aristotle Thales predicted by the stars that there would be a bumper olive harvest and bought options on the use of olive presses.

When the harvest did in fact prove to be a great harvest Thales was able to rent the presses at a significant profit.

When you buy an option you have the right but not the obligation to buy (**call**) or sell (**put**) a specific underlying asset at a prearranged price on or before a given date.

Similar to futures, options can give the holder protection against adverse price moves.

Calls and Puts

Call options when bought allow you to buy an asset at a fixed price (strike price) on or before a specific exercise date.

Exercise date: some options can only be exercised on a particular date and they are commonly known as European options. Options that can be exercised on or before the due date are commonly known as American options.

A Put option is the reverse of the call option. When you buy a put option it gives you the right but not the obligation to sell an underlying asset at a predetermined date.

Options are frequently used in real estate deals. A property developer may take the option on a piece of land he wants to develop. He may for example buy (call) the right to purchase a particular piece of land at $100,000 on or before sixty days beginning on the day he takes the option.

For the privilege of fixing the price for the next sixty days he agrees to give the seller $1000. This now gives him time to arrange any permits he may need to construct the building he wants. He also has the knowledge that he can buy that piece of property at any time in the next sixty days at the price he has already agreed upon.

If for some reason he cannot get the permits he needs then he simply does not exercise his option to purchase. He will of course forfeit the $1000 that he paid for the option. The seller in this case was obliged not to sell that piece of land to anyone else for the next sixty days.

The same process can be applied to almost anything. If you apply the example of the property deal to the stock market you get the same situation.

Lets assume you buy a call (right to buy) 100 shares of XYZ company at an agreed price (strike price) on an agreed date (expiration date) at say $40 per share and you pay $5 for the option.

If on or before the expiration date XYZ is trading at less than $40 per share then you would not exercise your option and you would have lost the price you paid on the option $5.

If Xyz Company is trading at $50 per share on or before the expiration date your option is in effect worth $10. This is the difference between the price you have an option to buy Xyz at in this case $40 and the price it is actually trading at $50. The reverse of this is a put (right to sell) option on an underlying asset. You might feel that the market is overheated at the present time and want to buy a put (right to sell) option.

REMEMBER

This will give the individual who bought the put option the right to sell that option at and agreed price (strike price) on or before a specific date (expiration date).

You can also sell options (as opposed to buying a put). The writing of call options can be extremely high risk and I would not advise this for new traders until they thoroughly understand their liability. Buying an option either call or put gives you rights, selling (writing) options gives you an obligation.

The day after the expiration date an option has no value. At this stage it may seem that the buyer of the option has all the cards but don't forget the seller of the option receives the money for granting the option. The money that is exchanges is commonly referred to as the premium.

Although option trading has more than its fair share of jargon remember the essence of all markets is that there is a buyer and a seller and **both believe they have an advantage and have the potential to make money**.

Think of an option in the same way that you would pay your house insurance company. The premium you pay each month gives you the right to a benefit if some event in the future happens and you decide to exercise your right to have the insurance company pay you for that event.

Think of an option in the same way that you would pay your house insurance company. The premium you pay each month gives you the right to a benefit if some event in the future happens and you decide to exercise your right to have the insurance company pay you for that event.

The insurance company on the other hand has the obligation to pay you should you should you exercise that right in exchange for accepting your premium each month.

Common Terminology

There are dozens of full glossaries on the web dedicated to trader terminology, and we recommend you invest some time in them. (www.investopedia.com) is a good start.

Long/Short

First, you should determine whether you want to buy or sell.

If you want to buy (which actually means buy the particular market (currency, contract, or share)), you want the market to rise in value and then you would sell it back at a higher price. In trader's talk, this is called "going long" or taking a "long position".

Just remember: long = buy.

If you want to sell (which actually means sell the market (share, contract, currency)), you want the market to fall in value and then you would buy it back at a lower price. This is called "going short" or taking a "short position".

REMEMBER

Short = sell.

Bid/Ask Spread

All quotes include a two-way price, the bid and ask. The bid is always lower than the ask price.

The bid is the price in which the dealer is willing to buy the base currency in exchange for the quote currency. This means the bid is the price at which you (as the trader) will sell.

The ask is the price at which the dealer will sell the market. This means the ask is the price at which you will buy.

TIP

The difference between the bid and the ask price is popularly known as the **spread.**

Margin

I don't have enough money to buy $10,000 worth of XYZ. Can I still trade?

You can with margin trading!

Margin trading is simply the term used for trading with borrowed capital. This is how you're able to open $10,000 or $100,000 positions with as little as $50 or $1,000. You can conduct relatively large transactions, very quickly and cheaply, with a small amount of initial capital.

What the heck is a Margin Call?

In the event that money in your account falls below margin requirements (usable margin), your broker will close some or all open positions. This prevents your account from falling into a negative balance, even in a highly volatile, fast moving market.

If your losses exceed your usable margin of $9,000, you will get a margin call.

Make sure you know the difference between **usable margin** and **used margin**.

If the equity (the value of your account) falls below your usable margin due to trading losses, you will either have to deposit more money or your broker will close your position to limit your risk and his risk. As a result, you can never lose more than you deposit.

If you are going to trade on a margin account, it's vital that you know what your broker's policies are on margin accounts.

You should also know that most brokers require a higher margin during the weekends. This may take the form of 1% margin during the week and if you intend to hold the position over the weekend it may rise to 2% or higher.

The topic of margin is a touchy subject and some argue that too much margin is dangerous. It all depends on the individual. The important thing to remember is that you thoroughly understand your broker's policies regarding margin and that you understand and are comfortable with the risks involved.

Leverage

You are probably wondering how a small investor like yourself can trade such large amounts of money.

Think of your broker as a bank who basically fronts you $100,000 to buy XYZ and all he asks from you is that you give him $1,000 as a good faith deposit, which he will hold you for but not necessarily keep. Sounds too good to be true? Well this is how trading using leverage works.

The amount of leverage you use will depend on your broker and what you feel comfortable with.

Typically the broker will require a minimum account size, also known as account margin or initial margin. Once you have deposited your money you will then be able to trade. The broker will also specify how much they require per position (lots, contracts , shares) traded.

TECHNICAL STUFF

For example, for every $1,000 you have, you can trade 1 XYZ of $100,000. So if you have $5,000 they may allow you to trade up to $500,000 of contracts/lots/shares.

The minimum security (margin) for each lot will vary from broker to broker. In the example above, the broker required a one percent margin. This means that for every $100,000 traded, the broker wants $1,000 as a deposit on the position.

Some brokers describe their leveraging in terms of a leverage ratio and other in terms of a margin percentage. The simple relationship between the two terms is:

Leverage = 100 / Margin Percent

Margin Percent = 100 / Leverage

Leverage is conventionally displayed as a ratio, such 100:1 or 200:1.

Order Types

There are some basic order types that all brokers provide and some others that sound weird. The basic ones are:

Market order

A market order is an order to buy or sell at the current market price. If you wanted to buy at this exact price, you would click buy and your trading platform would instantly execute a buy order at that exact price. If you ever shop on Amazon.com, it's (kinda) like using their 1-Click ordering. You like the current price, you click once and it's yours!

Limit order

A limit order is an order placed to buy or sell at a certain price. The order essentially contains two variables, price and duration. For example, S&P is currently trading at 1525.25. You want to go long if the price reaches 1527.00. You can either sit in front of your monitor and wait for it to hit 1527.00 (at which point you would click a buy market order), or you can set a buy limit order at 1527.00 (then you could walk away from your computer to attend your ballroom dancing class). If the price goes up to 1527.00, your trading platform will automatically execute a buy order at that exact price. You specify the price at which you wish to buy/sell a certain market and also specify how long you want the order to remain active (GTC or GFD) (more on this later).

Stop-loss order

A stop-loss order is a limit order linked to an open trade for the purpose of preventing additional losses if price goes against you. A stop-loss order remains in effect until the position is liquidated or you cancel the stop-loss order. For example, you went long (buy) S&P at 1527.00. To limit your maximum loss, you set a stop-loss order at 1520.00. This means if you were dead wrong and S&P drops to 1520.00 instead of moving up, your trading platform would automatically execute a sell order at 1520.00 and close out your position for a 7 point pip loss.

TIP

Stop-losses are extremely useful if you don't want to sit in front of your monitor all day worried that you will lose all your money.

GTC (Good 'til canceled)

A GTC order remains active in the market until you decide to cancel it. Your broker will not cancel the order at any time. Therefore it's your responsibility to remember that you have the order scheduled.

GFD (Good for the day)

A GFD order remains active in the market until the end of the trading day. Because foreign exchange is a 24-hour market, this usually means 5pm EST since that that's U.S. markets close, but I'd recommend you double check with your broker.

OCO (Order cancels other)

An OCO order is a mixture of two limit and/or stop-loss orders. Two orders with price and duration variables are placed above and below the current price. When one of the orders is executed the other order is canceled.

TECHNICAL STUFF

Example: The price of S&P is 1550. You want to either buy at 1555 over the resistance level in anticipation of a breakout or initiate a selling position if the price falls below 1540. The understanding is that if 1555 is reached, you will buy order will be triggered and the 1540 sell order will be automatically canceled.

Always check with your broker for specific order information and to see if any rollover fees will be applied if a position is held longer than one day. Keeping your ordering rules simple is the best strategy.
Summary

The basic order types (market, stop loss, and limit) are usually all that most traders ever need. Unless you are a veteran trader (yeah right), don't get fancy and design a system of trading requiring a large number of orders sandwiched in the market at all times – stick with the basic stuff first.

Make sure you fully understand and are comfortable with your broker's order entry system before executing a trade.

WARNING

DO NOT make a trade with real money until you have an extremely high comfort level with the trading platform and order entry system.

Liquidity

The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity.

It is safer to invest in liquid assets than illiquid ones because it is easier for you to get your money out of the investment.

Volatility

Volatility refers to the amount of uncertainty or risk about the size of changes in a security's value. A higher volatility means that a security's value can potentially be spread out over a larger range of values.

This means that the price of the security can change dramatically over a short time period in either direction. Whereas a lower volatility would mean that a security's value does not fluctuate dramatically, but changes in value at a steady pace over a period of time.

Brokers

When selecting a prospective broker, find out with which regulatory agencies it is registered with. Regulation is typically reactive, meaning only **after** you've been bamboozled out of your entire savings will something be done.

In the United States a broker should be registered as a Futures Commission Merchant (FCM) with the Commodity Futures Trading Commission (CFTC) and a NFA member. The CFTC and NFA were made to protect the public against fraud, manipulation, and abusive trade practices.

You can verify Commodity Futures Trading Commission (CFTC) registration and NFA membership status of a particular broker and check their disciplinary history by phoning NFA at (800) 621-3570 or by checking the broker/firm information section (BASIC) of NFA's Web site at

www.nfa.futures.org/basicnet/

Among the registered firms, look for those with clean regulatory records and solid financials. Stay away from non-regulated firms!

Can you contact the firm by phone, email, chat, etc.? Do the reps seem knowledgeable? The quality of support can vary drastically from broker to broker, so be sure to check them out before opening an account.

WARNING

In the unfortunate event of a power outage, internet disconnection, or computer crash, you will want to have IMMEDIATE access to your broker to flatten ALL of your positions and cancel all orders resting in the market.

TIP

Here's a good tip: choose several online brokers and contact their help desks. Seeing how quickly they respond to your questions can be key in gauging how they will respond to your needs. If you don't get a speedy reply and a satisfactory answer to your question, you certainly wouldn't want to trust them with your business. Just be aware that as in other types of businesses, pre-sales service might be better than post-sales service.

Be sure to scrutinize a prospective broker's "fine print" section to be fully aware of all the nuances that a specific broker may impose on a new trader.

Finding the right broker is a critical part of the process. It's not easy and requires some real work on your part.

Leverage

The textbook definition of "leverage" is having the ability to control a large amount of money using none or very little of your own money and borrowing the rest.

For example, you can control $100,000 with a $1,000 deposit. Your leverage, which is expressed in ratios, is now 100:1. You're now controlling $100,000 with $1,000.

Let's say the $100,000 investment rises in value to $101,000 or $1,000. If you had to come up with the entire $100,000 capital yourself, your return would be a puny 1% ($1,000 gain / $100,000 initial investment). This is also called 1:1 leverage. Of course, I think 1:1 leverage is a misnomer because if you have to come up with the entire amount you're trying to control, where is the leverage in that?

Fortunately, you're not leveraged 1:1, you're leveraged 100:1. You only had to come up with $1,000 of your money, so your return is a groovy 100% ($1,000 gain / $1,000 initial investment).

Now I want you to do a quick exercise. Calculate what your return would be if you lost $1,000.

If you calculated it the same way I did, you would have ended up with a -1% return using 1:1 leverage and a -100% return using 100:1 leverage.

You've probably heard the good ol' clichés like "Leverage is a double-edge sword." or "Leverage is a two-way street." Well….as you can see, these clichés weren't lying.

Margin

So what about the term “margin”? Excellent question , grasshopper.

Let’s go back to the earlier example:

“For example, you can control $100,000 with a $1,000 deposit. Your leverage, which is expressed in ratios, is now 100:1. You’re now controlling $100,000 with $1,000.”

The $1,000 deposit is “margin” you had to give in order to use leverage.

TIP

Margin is the amount of money needed as a “good faith deposit” to open a position with your broker. It is used by your broker to maintain your position. Your broker basically takes your margin deposit and pools them with everyone else’s margin deposits, and uses this one “super margin deposit” to be able to place trades with the exchanges.

Margin is usually expressed as a percentage of the full amount of the position. For example, most brokers say they require 2%, 1%, .5% or .25% margin.

Based on the margin required by your broker, you can calculate the maximum leverage you can wield with your trading account.

If your broker requires 2% margin, you have a leverage of 50:1. Here are the other popular leverage “flavors” most brokers offer:

Margin Required	Maximum Leverage
5%	20:1
3%	33:1
2%	50:1
1%	100:1
.5%	200:1
.25%	400:1

Aside from “margin required”, you will probably see other “margin” terms in your trading platform. There is much confusion about what these different “margins” mean so I will try my best to define each term:

- ✓ **Margin required:** This is an easy one because I just talked about. It is the amount of money your brokers requires from you to open a position. It is expressed in percentages.
- ✓ **Account margin:** This is just another phrase for your trading bankroll. It’s the total amount of money you have in your trading account.
- ✓ **Used margin:** The amount of money that your broker has “locked up” to keep your current positions open. While this money is still yours, you can’t touch it until your broker gives it back to you either when you close your current positions or when you receive a margin call.
- ✓ **Usable margin:** This is the money in your account that is available to open new positions.
- ✓ **Margin call:** If the equity in the account drops below your usable margin, a margin call will occur and some or all open positions will be closed by the dealing desk at the market price.

Demo Trading / Paper Trading / Simulation

You can open a demo account for free with most brokers. This account has the full capabilities of a "real" account.

Why is it free?

It’s because the broker wants you to learn the ins and outs of their trading platform, and have a good time trading without risk, so you’ll fall in love with them and deposit real money.

The demo account allows you to learn about the markets and test your trading skills with ZERO risk.

YOU SHOULD DEMO TRADE FOR AT LEAST 2 MONTHS BEFORE YOU EVEN THINK ABOUT PUTTING REAL MONEY ON THE LINE.

I REPEAT - YOU SHOULD DEMO TRADE FOR AT LEAST 2 MONTHS BEFORE YOU EVEN THINK ABOUT PUTTING REAL MONEY ON THE LINE.

Place your hand on your heart and say...

"I will demo trade for at least 2 months before I trade with real money."

Now touch your head with your index finger and say...

"I am a **smart** and **patient** trader!"

Once you've made the time to get properly educated, demo trade, and save up sufficient capital, the time will come where you will have to tackle the markets. By this time you should've have learned the mechanics of trading and methods to analyze the market that you are most confident using.

- But are you ready to risk your hard-earned money?
- Can you put your money where your mouth is?
- Can you handle the (emotional, psychological and financial/economic) pressure of the occasional losing streak and account drawdown?
- Will you be able to control your excitement on a profitable trade?
- Can you let go of your last trade and completely focus on your next opportunity?

What separates the profitable traders from the unprofitable ones is that profitable traders can handle the pressure of risk and control their emotions.

They realize that losing is just a part of business. Those who have enough confidence in their methods and systems know that a drawdown is a short-term setback and they will soon recover.

This final crucial lesson can't really be taught. It will take time and experience. You have to put in the hours. You will have to go through a gazillion different trades and different market environments before you grasp and live these concepts. If you can't do this or aren't willing to, then ultimately, trading may not be for you.

Trading Plan

In later chapters we will dig deeper into Trading Plan Development, but this section will give a general overview.

> You can fill your mind with plenty of information, but without a good trading plan and the discipline to stick to it, you will NEVER be profitable.

Think of your trading plan as your map to success. It will be a constant reminder of how you will make money in this market. Of course it's not required, and if you can make your living by trading without a plan, you will be the first in history.

So you CAN trade without a plan if you want, but before you make that decision, let us give you a few reasons WHY you should have one.

Why Have a Trading Plan?

Reason 1: It keeps you in the right direction

Consistency is very important to have in your trading routine because it allows you to truly measure how successful you are as a trader. If you have a sound trading system but always break your rules, how can you ever really know how good your system really is? Your trading plan will keep you on target. Read it every day and stick to it.

Reason 2: Trading is a business and successful businesses ALWAYS have plans

I have never seen a successful business not start out with a plan. Do you honestly think Walmart was just created on a whim and then magically became successful? Or what about McDonalds? I'm sure almost anyone can make a better hamburger than McDonalds, but the difference between them and the individual is that they have a successful business plan that guides them to success.

REMEMBER

Now you know **why** you should have a trading plan. Let's find out what makes up a trading plan...

REMEMBER

Trading plans can be as simple or complex as you want it, but the most important thing is that you actually HAVE a plan and you FOLLOW the plan. With that said, here are some of the essentials that every trading plan should have.

1. A trading system

This is the heart of your trading plan.

The trading system is a set of rules for entering and exiting trades.

Most trading systems follow an IF / THEN qualification process to qualify each trade as a "signal"

For example:

- ✓ **Rule # 1 - IF** the 8 period moving average crosses the 65 period Moving Average **THEN…**
- ✓ **Rule # 2 - IF** the price closes above the 65 Moving Average on a 3 minute chart **THEN…**
- ✓ **Rule # 3 - IF** the price volume bar is greater that 500 and less than 1000 **THEN**
- ✓ **Rule # 4 - IF** the reading on the RSI indicator is less than 40 **THEN**
- ✓ **Rule # 5 - Buy 2 contracts at Market**
- ✓ **Rule # 6 - Profit Target 1 (**Limit order) at 1.5 above entry price
- ✓ **Rule # 7 - Profit Target 2** (Limit Order) at 2.5 above entry price
- ✓ **Rule # 8 - Stop Loss** (stop order) at 2 points below entry price

REMEMBER

Now you have a set of rules that you can back test to see if your model is profitable or not. This is called "finding the expectancy". (more on expectancy later)

This system should be one that you have thoroughly back tested, and have traded for at least two months on a demo account.

Include all the necessary information about your system such as: time frames you use, criteria for entries and exits, how much you risk during each trade, which currency pair(s) you trade and how many lots you trade.

Example: I am an intra-day trader and I trade off of the 10 minute charts. I enter when there is a moving average crossover and all my indicators support the direction. I only trade the XYZ market.

2. Your trading routine

This is a crucial part of your plan because it will determine three very important things: when you will analyze the market and plan your trades, when you will actually watch the market to take trades, and when you will evaluate your actions during your trading day.

3. Your mindset

Ask any trader out there and they will all tell you that one of the hardest things to do when trading is to take out your emotions from it. This section of your trading plan will describe what frame of mind you will be in when you are trading.

Example:

- ✓ I will see what is on the charts and not what I want to see.
- ✓ No matter how biased I am towards a direction, I will make sure to trade only what my eyes see and not what my feelings tell me.
- ✓ I will not get “revenge” on the market if I lose on a trade.
- ✓ I will not beat myself up if I make a losing trade. Instead I will take it as a learning experience and move on.

4. Your weaknesses

Yes, we all have our weaknesses. We just don't like talking about them. But ask yourself this, "How will you ever get better, if you don't admit to what you need to work on?" This section will be an objective way to keep track of things that you need to work on in order to become a better trader.

Example:

> ✓ I tend to overtrade. Whenever I lose on a position, I get upset and immediately try to get "revenge" on the market.
>
> ✓ I tend to exit early on trades.
>
> ✓ I don't stick to the rules of my system every time
>
> ✓ I don't stick to my money management rules every time

5. Your goals

"To make a lot of money" is not a good goal. Sit down and really think about what you want to accomplish as a trader. Do you want to trade for a living? How much return can you realistically expect from trading based on your knowledge and experience? Your goals don't even have to be about making money. Maybe you would like to be more disciplined or gain more confidence. These goals can be personal. What do YOU want to get out of this? Use these goals as your motivation when times get tough. These goals will be your vision, and you must always keep your eyes on the prize!

6. Your trading journal

This will be a valuable tool to helping you become a better trader. Make sure you log all your trades and why you took them. Later down the road you can look back and evaluate your trades and see how you are progressing. I've looked back at my trade journal and have seen just how much I've grown as a trader. My first entries were very basic and as I've progressed, my trades make more sense to me now. I've gained a lot of confidence throughout my career and by looking back at my trades, I've really been able to evaluate myself and see if I am getting closer to my goals. This tool will help you tremendously in the long run, so take a few minutes each day and log your trades. You'll be happy you did!

Your trading plan will be your trading "bible".

Read it everyday and stick to it.

You can have all the trading tools in the world, but if you don't have a plan on how you will use them, you will never be successful.

Remember, you are starting a business, and if you want your business to succeed, you need to have a PLAN!

Essentials

Traders must have the proper tools to do business in online trading.

Make sure you have and are **proficient** with the following before continuing to trade:

- ✓ A fast PC – A PC no more than 2 years old should be enough to keep up with the industry standard software. Mac's are unfavored in the trading industry.
- ✓ Multiple Monitor Setup
- ✓ Charting Software
- ✓ Trade Execution Software (some charting packages can execute trades now)
- ✓ High Speed Internet connection (don't think about trading without it)
- ✓ Ample trading capital (10K minimum for mini account)
- ✓ Broker Account

Don't Get Wrapped Up

Traders who take advantage of the opportunity to learn how to trade a system do not guarantee that they will either learn it or use it. Most people are still more comfortable with the status quo.

Sustaining the focus, self-discipline and recognition of reality required by proper trading is absolutely critical.

Most people would rather simply watch CNBC or chat at Motley Fool, rather than learn how to trade correctly. They are committed to neither the trading process nor the only real goal of trading — profits. The people who delve into the status quo are more interested in being "right" than being profitable.

REMEMBER

If you are more interested in calling the shots, this career is not for you.

Final Thoughts

This is the end of this chapter and hopefully you have a proper and realistic expectation of trading.

We know that traders who approach trading with a realistic expectation have a MUCH higher success rate in the markets.

We genuinely want you to succeed in trading, and by informing traders of what the "real' markets are about, we have found that traders are more equipped to do their day-to-day repetitions in the market more consistently, ultimately seeing consistent returns.

You can do it!

To your continued success,

-TradeEmpowered.com