Catherine Davey

The Diary of a CFD Trader

How to make *serious* money from contracts for difference

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How to make serious money from contracts for difference

Catherine Davey

HARRIMAN HOUSE LTD
3A Penns Road
Petersfield
Hampshire
GU32 2EW
GREAT BRITAIN

Tel: +44 (0)1730 233870
Fax: +44 (0)1730 233880
Email: enquiries@harriman-house.com
Website: www.harriman-house.com

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Preface to the 2009 edition

I originally wrote this book in 2006, when markets were booming and no one could see an end to the good times. It's now late 2008 and the financial markets – and indeed the global economy – are a very different place. However, over this period CFDs have gone from strength to strength, such that trading in them is expected to soon reach countries like the United States and Japan.

But trading of any kind – including CFDs – is not easy. I still believe trading is the most demanding endeavour you will ever undertake. When I was a futures broker I saw very successful lawyers, doctors, accountants and engineers try to become successful traders and fail. Profitable trading, especially the achievement of long-term consistent profits, requires a vastly different skill-set from most other careers. The rules that apply to succeeding in most normal careers – hard work, good customer service, clever marketing, smart networking – are all useless in trading.

Writing this book added an extra pressure to my trading because I knew that the motivations and results would be made public. With hindsight I realise the profit I made was despite myself, not because of any great trading talents. These will become obvious as you read the book because I have done my best to highlight the errors of my ways and offer smarter alternatives. Above all, you will notice I lacked discipline and consistency. This should be some comfort for new CFD traders because these two skills are not something God-given, but can be easily nurtured.

Finally, I'd like to offer a new piece of advice: do whatever it takes to 'de-emotionalise' your trading. The highs of trading success will always be more than cancelled out by the lows when you are not trading from a rock-solid foundation of objective market knowledge and confidence. Having interviewed many experienced traders over the years as a journalist, the common factor of unsuccessful (and unhappy) traders is an inability to divorce who they are from the trades they make. This book is a working example of my own journey to rise above that common affliction.

For non-Australian readers

When I wrote this book I was mainly trading Australian stocks and so these are the trades that I mention here. However, all my trades were driven by technical analysis (not specific to the Australian market), and the trading lessons learnt are equally applicable to CFDs trading in any market.

Note: Charts of the companies I traded can be found at http://au.finance.yahoo.com (although not all the companies still exist).

Catherine Davey

Sydney, 2008

Preface to the 2006 edition

I wrote my first book, *Contracts for Difference: Master the Trading Revolution*, in 2003. I had stumbled upon contracts for difference, or 'CFDs', when I was writing a story for Australian financial website InvestorWeb in 2002. Back then CFDs were virtually unknown in Australia and attracted no media attention. Less than a year later, my book had hit the stores and the revolution was well on its way. Now CFDs are the hot new product for private traders, with a fan club from every corner of the trading and investing world, including former futures traders, hedge fund managers and of course traditional share traders. When I started writing my first book there were just two CFD providers in Australia; now there are around half-a-dozen, and the number has continued to grow during the time it has taken me to write this book.

My dream had always been eventually to trade for a living. CFDs made that goal seem much more attractive and easier to attain.

I joined the swelling ranks of CFD traders in 2004, paring back my freelance commitments so that I could realise my ambition. I quickly discovered that the difference between writing about CFDs and actually trading them was significant. Having spent six years working as the in-house technical analyst for InvestorWeb, I had considered myself a competent market commentator and analyst. At different times in my career I had traded shares and other derivative products, admittedly with mostly limited success, but I believed I had accumulated enough experience to avoid some of the pitfalls the average trader faces. I was wrong. Not only did I have to negotiate all the old traps again, but I also had to become familiar with the unique aspects of CFD trading.

The core of this book is a trading diary I kept over a three-month period in 2005, trading CFDs full time. Between the end of June and the end of September, I turned $13,000 into more than $30,000, but it was not easy. My path to success was not simple, nor straight, and I did not hit the ground running. Before I started writing this book I was in a losing cycle, which continued as the first weeks passed. I made many obvious mistakes from the outset and continued to make many of these same mistakes as the book progressed. There was one point at which I thought seriously about giving up on both trading and writing the book. I spent time crying on the shoulders of friends and family. I questioned my ability to trade and my self-esteem took a battering. I think these feelings are common to all traders.

It has been my aim to provide a book that not only describes a practical means of potentially making money from CFDs, but also presents an honest discussion of the emotional journey. I am hoping my honesty will comfort and inspire anyone going through the inevitable emotional downside we all encounter at some stage and with a certain amount of regularity, in our trading. I hope, too, that the positive lessons I have learnt will inspire you.

Catherine Davey

Sydney, 2006

Introduction

What are CFDs?

Contracts for difference, or 'CFDs', are a derivative trading instrument – their value is derived from or determined by the price of a stock being traded on a market. When you enter into a contract for difference with a provider, you are in effect taking a bet on a stock's future price action. You enter a contract or 'open a position' when a particular stock is trading at a specific price; the CFD provider agrees that when you close the position, terminating the contract, it will pay you the difference between the stock's starting price and the price it is currently trading at.

For example, if the price of Telstra shares is quoted on the Australian Stock Exchange (ASX) at $4.35, a Telstra share CFD will be quoted at the same price. If you buy 100 Telstra share CFDs at this price, and Telstra shares subsequently trade at $4.40, you can close the position and take a profit of $5 – the difference between the underlying shares' initial value of $435 and their subsequent value of $440. If, on the other hand, the price the shares are trading at falls to $4.30, and you close the position, you will lose $5. You don't own shares in Telstra at any point in this scenario: you are only speculating on their price movement. CFDs mirror the price of shares, allowing traders to take advantage of share price movements without actually owning physical shares.

Why CFDs?

I was first attracted to the idea of trading CFDs because, unlike other derivative instruments available, their price action is exactly like the price action of their underlying product. As a technical analyst, making trading decisions on the basis of chart patterns, I saw benefits in being able to scan the charts of the underlying share and use the information gleaned there to trade the CFD, knowing that their price movements would be identical. From a price perspective, CFDs and shares were the same, but for my purposes CFDs were better. Unlike options or warrants, they would allow me to get set in a market that had no expiry date and traded no premium.

I had spent years analysing shares for InvestorWeb. As a former futures broker and trader, I thought the share market seemed a much gentler and easier market to trade. While a futures market such as pork bellies or coffee can go through the equivalent of a stock market crash and recovery in a few hours, share prices are like the country cousin, moving relatively slowly. CFDs would allow me to trade the gentle world of shares and get the same bang for my buck that a futures market would provide. The bang would be supplied by leverage – in my opinion, CFDs' greatest advantage. With limited funds – in my case, just $13,000 – extraordinary gains can be accumulated. Leverage is the launching pad that can turn a sometime investor into a full-scale trader. To understand the miraculous power of leverage consider this: during the time I kept my trading diary, the S&P/ASX 200 increased around 9.6%, which isn't bad if you annualise it to 38%, but in that same three-month period my account balance grew over 132%. Annualise that figure and it becomes ridiculous!

CFD trading also attracts low brokerage charges. With my CFD provider I can enter a trade for as little as $10. This makes CFDs a very powerful learning tool. Small trades with low brokerage allow new traders the opportunity to get their feet wet without getting killed with commissions. As little as one share can be traded at a time. It might seem ludicrous to start so small, but if you've never traded before, the process of trading just one share gives you the same feelings as trading a more realistically sized order: it is an opportunity to practise trading discipline without the risks and stress of larger exposure to the market.

Another key advantage of CFDs is that they can be traded profitably even when the market is going down. One of the big problems with traditional share investing for me has always been the difficulty in making money when the market is falling. With its focus on positive price growth, old school share trading is only half the story. My futures background has taught me that a falling market is often as good and sometimes an even better money-making opportunity than a rising market. It is the ability to profit from a fall in prices that separates traders from investors, and CFDs make this very easy. The market will periodically enter a downturn and eventually there will be a long-term correction. Both of these events are potentially profitable for CFD traders.

Why a trading diary?

Trading for a living is different from running any other kind of small business. There are no customers to entice, no products to sell. Instead, trading is a relationship between you and the market. Like any relationship, its success depends upon the effort and respect you give it. Once you've been in the trading game for a while, you'll start to notice how frequently educators and successful traders talk about the importance of keeping a trading diary. Writing in diary form allows you to describe not just the actual trades you take, but also how you feel and the measures you employ to succeed in the trading process. Trading is not just a matter of making or losing money: your emotional reaction to each loss and win perpetuates your trading success or failure.

As I updated my own diary over the three-month period, I was able to see the benefits of this practice directly. It not only forced me to investigate my emotional response to trading, but also showed me the logical and sometimes illogical reasons I had for taking trades. I would normally describe my trading as intuition-driven and haphazard, but keeping a trading diary revealed that there was method in my madness and helped me crystallise my approach.

The diary forced me to look for reasons for victory or defeat, when usually I would simply move on without introspection or self-analysis. Until I started to keep a record, I had no idea how often I would repeat my mistakes and contradict myself, or how easy it was for me to slip into bad habits. I am hoping that by exposing my frailties as a trader, I will help you feel less alone and empower you to confront your own weaknesses.

I have shared moments in the diary that, in retrospect, were extremely personal and made me feel vulnerable. My ability to share such moments makes me glad to be a woman, because talking about feelings and confessing flaws seems to come easier for us. However, the emotional processes that are part of the trading journey are the same for both sexes. The cycle of success, loss, fear, desperation, hope and hopelessness does not discriminate between men and women. My aim has been to provide all readers with ideas to help them deal with this inevitable cycle.

A final, and probably the most important, reason I had for keeping this diary was to bring some credibility to trading as an occupation. Big claims and spectacular gains are so commonplace in the investment and trading world that it makes the whole business seem dubious. This is partly due to the number of authors and educators in the field who do not trade. I met plenty as a futures broker: some of the highest profile commentators in Australia were also some of the worst traders on our books. The diary format offered me the opportunity to 'walk the talk'– to offer a truthful and realistic picture of making money from trading.

The characters in this book

Although my trading diary provides the central focus of this book, I am not the only character in this story. I trade from my home office in an eastern Sydney beachside suburb, and my daytime companion is my small dog. One of my flatmates is also home sometimes during the day, and he occasionally comes to talk to me about the garden, among other topics. I am not always interested in the rockery he has built, especially when the market is very volatile. He's a former institutional and private trader, so he understands that sometimes the market is too busy for me to talk about the pansies. If you are trying to trade from home it is important to set these sorts of boundaries with family.

Throughout the period in which I was keeping my diary, I was lucky enough to have access to the director of a CFD provider. I have included my actual conversations with him and the advice he gave me in this book. I didn't always agree with him, and sometimes did directly the opposite of his recommendation, but his thoughts on the market are always worth considering – he has been both an institutional and independent trader, and has been involved in CFDs since they were introduced in the UK in 1999. He is referred to as The Director.

Other characters in the book include David L, an analyst and commentator, and Ashley J, a trading educator and coach. David L and I exchanged ideas on the market on a daily basis. Again, we disagreed plenty of times, but his input was still valuable.

You will discover some other recurring characters, but I don't want to spoil the surprise.

How to use this book

I have structured this book to allow you to follow the action in my trading diary and learn as you go. Each day's diary entry begins with a figure representing the balance of my account as it appears on my broker's statement. It varies from day to day, fluctuating as I close existing positions and enter new ones, and as the prices of the CFDs I trade move up and down. At first all my trades are on the local market, but after a while you will see a second figure appear: this is the running profit and loss of my US dollar exposure.

Each week of trading is contained within a separate chapter. At the end of each chapter you will find a cumulative profit and loss total. This is based purely on positions I have closed out, and brokerage and interest charges have been deducted. Underneath the weekly profit and loss you will find a list of my trading statistics, including my biggest winning trade of the week, the biggest loser, my win/loss ratio and a summary of my performance during the week.

The diary entries for the week are followed by sections called 'What have I learnt?' and 'Do's and don'ts'. In these sections I share my thoughts on my performance during the week and my strengths and weaknesses, identifying the lessons I have learnt that I can pass on to readers. Unfortunately, mistakes I made were often repeated, as I didn't necessarily learn from them myself, but I hope you will benefit from my experience.

Following the diary entries for each week is a section called 'Lingo and lessons', in which I explain new terminology and trader's jargon, offer observations I've made during the course of the week and elaborate on important points that I felt the reader should understand.

After the lingo and lessons in each chapter, you will find a trading tip – a repeatable entry or exit strategy based on important practical insights I have gained through observation of the market and trading during the week. The trading tip section includes a chart or diagram for an easy visual reference.

I assume that readers have a basic knowledge of the sharemarket, and are familiar with trading jargon, but where I thought it might be necessary to introduce a new term, I have added a definition to the 'Lingo and lessons' section at the end of each week's diary entries. New words which appear in the lingo section are bolded when they first appear in the text.

I also assume that the reader is familiar with the basic concepts of technical analysis, and knows how to read a candlestick chart, showing a stock's price action. If you need further information about technical analysis, try John J. Murphy's bible, *Technical Analysis of the Financial Markets* (Prentice Hall Press, 1999). For an introduction to reading candlesticks, I'd recommend Louise Bedford's *The Secret of Candlestick Charting* (Wrightbooks, 2000).

This book concludes with a graph of my performance relative to the S&P/ASX 200 – the standard investment management benchmark. This graph provides insight into the day-to-day volatility of my profit and loss, as well as a realistic point of comparison with the market index.

An important development since my last book was published has been a spectacular resumption of the bull market for Australian shares. My trading diary was written during this period of strong growth, and this has obviously given the book a bullish bias: I have gone long on CFDs more often than I have gone short. I believe a raging uptrend can give new CFDs traders an unrealistic opinion of their trading ability. Preserving profits from profitable positions when there is a correction and making money from falls in the market are just as important as exploiting the upside. I made regular attempts to make money from a falling market with varying success; however, given the market's upward bias, the downside probably didn't receive the attention it deserved on a day-to-day basis. To address this, I have included a discussion about making money from the downside in the last chapter.

I am glad to have been involved with CFDs almost since their inception in this country. My first book had a theoretical approach; I am hoping that this book will provide traders with practical and realistic steps they can follow in order to trade CFDs successfully.

Getting started

In this preliminary chapter, I will explain some basic concepts and then outline my trading approach. If you are already an experienced trader, comfortable with sharemarket jargon, you can probably skip over the basic concepts and go straight to the details about my trading method.

Market jargon

Feedback from showing early drafts of this book to peers indicated that I used a lot of market jargon. Working on dealing desks and as a broker means the jargon has become second nature to me. For the average private trader, it's not always obvious what the jargon means, so I have added this section here at the beginning of the book to lay a foundation of terms commonly used throughout.

Long or short/bull or bear

If you've ever traded shares, you are probably familiar with the terms 'bull' and 'bear', but you won't necessarily be familiar with the idea of 'going long' or 'going short'. Most share investors aim to buy and hold and then sell at a profit when the market goes up. With CFDs, you can make money from prices going up, but you can also make money when prices go down. If you think the market is going up, you're a bull, and you are likely to take a long position. If you think the market is going down, you're a bear, and you're likely to take a short position.

Going long means entering a position by buying something and then selling it when the price has risen. Going short means entering a position by selling something you don't actually own, and buying it back when the price has fallen.

Just say the price of BlueScope Steel (BSL) is quoted as $8.35-$8.36. If I expect the price to rise, I will go long by buying at the offer price of $8.36. This gives me a long position. I will make money if I exit the position by selling at a price above $8.36. If I expect the price to fall, I will go short by selling at the bid price of $8.35. This will give me a 'short position'. I will make money if I exit the position by buying at a price below my entry at $8.35.

Some people have a bent for the upside or the downside – you're either a natural bull or natural bear. I'm a natural bear, so I find it hard not to go short no matter how bullish the market is.

A benefit of going short CFDs is that you will be paid interest on the position. If you have a long position, you have all the benefits that someone holding physical shares enjoys, such as dividends, although you do not receive voting rights.

If you have trouble with the concept of going short, don't feel bad – it does seem strange at first. I spent half an hour with one of my flatmates trying to explain the idea of selling something you don't own, and he's a doctor!

Margin and leverage

CFDs are a unique way of trading share price action, requiring only a fraction of the capital you would need to trade physical shares. The amount of cash you must deposit as margin varies from one CFD provider to another, but the going rate is usually somewhere between 3% and 20% of the value of the underlying shares. For instance, to trade a position worth $20,000 with 5% margin requirement, you will need a deposit of $1000. This equates to 20 times leverage.

Order book, market depth or price depth/bids and offers

When people refer to the ‘order book’, they are referring to all current buy and sell orders for a particular stock. These can be viewed on a ‘market depth’ or ‘price depth’ information screen. Your market depth screen will usually set out all buy orders for a stock, ranked in order from highest bid to lowest. It will also show you all sell orders, ranked from lowest offer to highest.

The ‘bid price’ is the best or highest price market participants are prepared to pay for a stock. The ‘offer price’ is the best or lowest price at which market participants are prepared to sell a stock. The screen shot below shows price depth for BlueScope Steel. The bid price is $8.35. The offer price is $8.36.

Figure 1. Bids and offers on the price depth screen


Price Depth BSL (Au)

9,274	8.350 /	8.360	208
9,515	8.340	8.370	3,000
9,160	8.330	8.380	2,900
12,025	8.320	8.390	16,882
5,500	8.310	8.400	25,000
27,040	8.300	8.410	2,000
20,189	8.290	8.420	6,500
300	8.280	8.430	15,983
1,360	8.270	8.440	2,000
5,659	8.260	8.450	4,100

Mid	8.3550	Change	-0.0300	High	8.380
Open	8.3450	% Chg.	-0.36%	Low	8.340
Close	8.3850				

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Volume and liquidity

Looking back at the price depth screen on the previous page, you will see that a column of smaller numbers runs beside the central columns that list the bids and offers. These smaller numbers represent the 'volume' – that is, the number of shares – which traders wish to buy or sell at each particular price. The number on the left-hand side of the bid price represents the volume traders wish to buy at that bid price. The number on the right-hand side of the offer price represents the volume traders wish to sell at that offer price. Our sample screenshot shows us that market participants want to buy 9274 share CFDs at the bid price of $8.35, and to sell 208 share CFDs at $8.36.

I consider market depth when deciding if a stock is looking strong or weak. Large numbers of orders at prices only incrementally below the best bid price indicate that the market is 'well bid'; that is, likely to be strong. Similarly, large numbers of sell orders at prices incrementally above the best offer price also indicate that the market is likely to be strong. However, this is not always the case: the order book can change quickly, and orders can be removed suddenly and at any time during the trading session.

Liquidity is shown in the number of orders and the volume of shares at each price level. High liquidity means there are many orders and large volume. Low liquidity means there is lower volume and/or few orders placed in the market.

Order types

Before you start trading, you need to know your order types so that you can use them to maximum advantage. The following is only a brief introduction; for more detail, please see my first book, *Contracts for Difference: Master the Trading Revolution* (Wrightbooks, 2003).

Market order – Entering on a market order means accepting the current bid price to go short or buying at the current offer price to go long. Market orders are used by traders who are eager to take a position immediately and are not interested in waiting for the price to go lower before buying or for it to rise before selling. For example, if BSL is quoted at $8.35-$8.36, to buy 'at market' would be to pay the current offer price of $8.36. To sell at market is to enter at the current bid price of $8.35. Nine times out of ten I will enter on a market order.

Limit order – A limit order is placed below the current market level for a buy order and above it for a sell order. A limit can be used to enter or exit a trade. If traders want to pay less than the current offer to buy, or sell at a price higher than the current bid price, they'll place a limit order. For example, if BSL is quoted at $8.35-$8.36, traders may want to wait, hoping that they will be able to buy at a price lower than $8.36. Therefore they might place an order to buy 'on limit' at $8.30.

Stop-loss order – In my trading diary, I will often note that I have been 'stopped out' of a position. This means my CFD provider closes my position because a stock's price has hit the level at which I have placed a stop-loss order. A stop-loss order is placed below the market for a long position and above the market for a short position, with the aim of limiting losses should the position go against you. Stop-loss orders do not only apply to losing positions; they can also be used to exit a winning position and realise profits.

Trailing stop-loss orders – To 'trail' a stop-loss order is to move the order closer to the current price in order to maximise profits or minimise losses from an open position. Setting a trailing stop is common practice when a position moves into profit and the market continues to move in the direction of the profitable trade. As a position becomes more profitable, I continue to trail my stop-loss level. Well, that's the theory. Your CFD provider will not trail a stop-loss order automatically. You must do this for yourself.

'One cancels other' order – If you have a clear target for a profitable exit, you might want to work a limit order in conjunction with a stop-loss order. This can be done with an order called 'one cancels other' (OCO). As soon as one 'leg' of the order is executed, the other side is immediately cancelled. An OCO is commonly used to simultaneously work orders to exit an existing position if it goes into loss, or to exit if it is in sufficient profit.

'If done' order – The 'if done' order is another contingent order that is handy if you are not able to watch price. If you are entering on a limit order, the 'if done' order can be attached to a stop-loss order, making sure that as soon as your entry is executed, you have a protective stop in place.

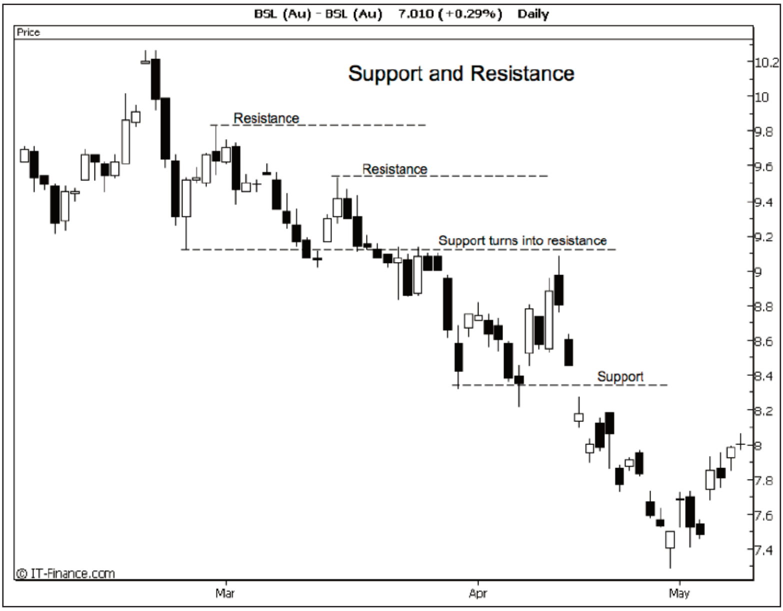
Support and resistance

Support levels and resistance levels are probably the most basic concepts of technical analysis, and they are the two most important tools of my trading strategy. A stock's support level is based on old chart lows. It is the point below the current price action at which downward price movement has halted in the past. A stock's resistance level is based on old chart highs, and is the point above the current price action at which upward price movement has previously halted. Support and resistance 'lines' can be plotted on a chart.

Looking at Figure 2, it is obvious that a support level, once breached to the downside, can become resistance, and vice versa.

Even if you use a trading system based on more advanced indicators, you should still be aware of support and resistance levels on a stock's chart. I am always looking for old chart reversal levels, and stay extra vigilant when prices get near these levels. If a support or resistance level can pause or stop a trend it is important; if a market shrugs it off, it says that trend has underlying strength.

Figure 2. Support and resistance



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Double bottoms and double tops

A double top pattern is a twice-tested high that is confirmed when the intervening low is breached on a closing basis. A double bottom is a twice-tested low that is confirmed when the intervening high between the two lows is breached on a closing basis.

A double bottom, especially in a bull market, is one of the most consistently reliable patterns. This pattern not only gives a safe buy signal, but usually provides an early buy signal, too, because the pattern is often the starting point for gains far greater than your initial pattern-based targets.

Spike tops and bottoms

Spike tops and bottoms are another favourite pattern of mine. They usually represent extremes of emotions and as such are terminal points of overbought or oversold conditions. They form within the day and require a fast reaction to exploit the turnaround.

Range

A stock's trading range is an important tool. Lots of my entry and exit signals are based on chart patterns that form when the price moves between resistance and support on several occasions, creating a rectangular pattern.

When a stock makes new lows and then starts trading within a relatively narrow price range without making new lows, this is called a basing range. Some stocks will often reverse into a sustainable new uptrend after the confirmation of such a pattern, while others will consistently make spike lows or rapid unchecked lows before resuming the uptrend.

'Consolidation' and 'congestion' are interchangeable terms which describe a trading range that does not result in a reversal in the trend. They are in effect a pause before the trend resumes and are equally important buy or sell signals.

Continuation pattern

A continuation pattern is seen when price movements resume in the direction of a trend which was established before a trading range started to form.

Intra-day break-outs

I also look at intra-day break-outs compared to closing levels. Rangebound or consolidation patterns often contain intra-day breaches of the range, but then close within the range. This is often a good buy signal in the case of a downside break and a good sell signal in the case of an upside break. I discuss this in the trading tip I present at the end of week 3.

My trading platform

Many of the best features of CFD trading are related to the kind of internet-based trading platforms that are around today. The best brokers now provide their clients with software offering a range of services, including charting facilities, news and online order placement. Having spent years executing futures orders by telephone, I believe this kind of facility makes my trading more disciplined, results in far fewer errors and saves me much of the stress and time involved in talking to a broker.

I use a market-market CFD platform that gives me flexibility in placing orders, along with instant access to the market and real-time profit and loss statements.

I have a series of prices for share and index CFDs loaded on my CFD trading platform.

The platform has a position-keeping log and pending order log, both of which are called ‘blotters’. I always keep both blotters open. This reminds me to place stop-loss orders for open positions at my predetermined price levels. It also alerts me when these orders are potentially ready to be executed – when a price trades near my predetermined level, this is highlighted on my pending order blotter. The position-keeping blotter is useful because it shows ‘tick-by-tick’ or incremental changes in a continuously updated running profit and loss.

The platform also allows me to build a favourites list of individual share CFDs. I remove a stock from this list if I have a bad run of trades on it and decide I should stop trading it. This takes away the temptation.

My CFD platform also offers a world of other trading opportunities aside from local share CFDs – an entry into sophisticated markets that are usually only open to traders who maintain separate accounts to trade foreign exchange or futures. I can access and trade real-time markets such as oil, gold, silver, wheat, overseas share CFDs and index CFDs, US and euro treasury bonds, every major currency, many minor ones and cross rates. Whichever market I choose, my trading platform gives me access to charting facilities, market depth information (where available), and also gives me the ability to 'back-test' trading systems.

The back-testing facility on my trading platform allows any technical indicator to be tested using historical data. This opens up a range of possibilities for new traders looking to devise a tradable system. I would recommend using the back-testing facility on a number of different stocks. You might find some systems work best using weekly charts rather than daily charts, or give better signals about some stocks than others. The best approach can only be determined by a process of trial and error. You will also find there is a difference between the results you get when you back-test a system and the outcomes you achieve using it in real life.

My trading method

Once you begin trading you will quickly discover there is no holy grail. The smartest way to make money is the way that suits you best, but you won't discover what this is until you start trading. The right approach will depend on your circumstances – whether you have a full-time job, how much time you can spend watching the screen, your financial means, and your actual analysis style. There is no single ideal approach, and developing your own trading style is a process of evolution.

I had my first trade back in the 1990s trading a US 30-year T-Bond futures contract on a joint account with my boyfriend at the time and another friend. The position was fabulously profitable at first, but then it turned down. We hung in there, but eventually took away only a meagre profit. That was the starting point of my trading education.

Like many trading neophytes, I studied the most complicated and esoteric strategies first. Gann, Elliott wave and astrology were some of the methods I subscribed to in my early days. They all worked, but each of them required an enormous amount of study and that made trading unenjoyable. Scouring an astronomical almanac for 'moon void of course' or 'Venus opposition Mars' was too laborious when all along I had the best trading tool staring me right in the face: pure price action on the chart. It took me years to realise just how important price was.

Acknowledging the importance of price led me to develop a trading approach that relies on some embarrassingly simple technical patterns.

I consider myself a 'break-out trader', that is, I buy stock once its price moves above a certain predetermined level and sell it when it drops below a certain level. I nearly always enter on a market order, which means that I pay the current offer price or sell at the current bid price, but I use a stop-loss order to exit. I very rarely use limit orders to open or close a position.

I have no mechanical trading approach and use no technical indicators and I don't care about volume traded, only volume on market depth. I watch price action, study the charts and am not afraid to buy high and sell low; stop and reverse; or get stopped out and re-enter in same direction if the price action says I should.

I also like to add to positions. This is sometimes called ‘pyramiding’ or ‘scaling-in’, and it means investing more in a position as it moves into profit. For example, imagine that you buy Aristocrat Leisure (ALL) at $10 for 1000 share CFDs. Each 1¢ move up or down in the price of ALL equals $10 that you have gained or lost. If the price of ALL goes up to $10.20, you might therefore decide to buy another parcel of 1000 shares. Now that you have doubled your exposure, every 1¢ price move means $20 is added to or subtracted from your account. As a position moves further in my favour, I continue to add, so that each incremental move in the underlying delivers increasing profits.

My trading approach could be characterised as having three basic steps:

1. Buy or sell on a break-out to enter.
2. Exit on a pullback for a buy or rebound for a sell.
3. Add to positions as they move in my favour and trail stop aggressively as profits grow.

I describe the various chart-based techniques I use in planning my entry and exit strategies throughout this book. You will also find a specific trading tip at the end of each chapter.

My stock selection criteria

I started trading a limited selection of share CFDs using an approach based on nothing more than trial and error. I first looked for stocks that obeyed the rules of technical analysis, forming familiar patterns and moving to target once the patterns were confirmed. I chose stocks which followed these rules to a degree that would allow me to implement strategies based on the pattern outlined above. My ‘usual suspects’ include Aristocrat Leisure (ALL), BlueScope Steel (BSL), Coles Myer (CML), Newcrest Mining (NCM), Excel Coal (EXL), Oxiana (OXR) and Jubilee Mines (JBM). There is one other stock that I began trading for the first time halfway through the book. It ended up being my most profitably traded CFD, but I won't tell you what it is just yet.

These days I know more about stock selection than when I started. The first thing I consider now is the market depth. As I explained above, market depth is the volume of interest from buyers and sellers – the number of offers or bids being made – at various price levels. You will find that market depth information becomes increasingly important as you become more serious about your trading. I rarely place an order, especially on the stocks that are traded at relatively low volumes, without checking the number of bids or offers being made first. This tells me whether there is enough volume available to cover my order.

Different stocks suit different traders. The names I gave above should not be read as a list of the best or the only share CFDs to trade. Some of those I have mentioned go off the boil at times, or become too unpredictable to trade. I am constantly trying new shares. You will find that some share CFDs might have a clear 'set-up' or entry pattern only infrequently – occasionally they may be very profitable, but the rest of the time they should be left alone. A good rule when considering trading a new share CFD is to check its liquidity. Thin or illiquid stocks, no matter how attractive their price action, can be frustrating and costly to trade. That was one of the best lessons I learnt when choosing which share CFDs to trade.

Apart from high chart predictability and good liquidity, the other criterion I base stock selection on is volatility. I am impatient, so trading a stock that takes two weeks to move 10¢ is agonising. It is not only boring, but also not cost-efficient. Every time I buy and hold a CFD position overnight I attract a financing charge. As long as the stock does nothing, it is costing me money.

Back-testing is another useful tool in stock selection. In the final month of my three-month trading period, I back-tested a system on my CFD platform and started trading it on a demo account. (I will discuss this in detail in my diary entries for week 11.) As it was only a demo account, I did not trade real money, so even though I was successful, my 'profits' on this account are not included in my final total profit figure. It was a departure from my normal trading style, which is much less rigid. However, the success of my back-testing experiment proves there is no single way to make money. It also is great inspiration for those traders hoping to make the break from full-time work to full-time trading. The trading system was based on a low-maintenance, end-of-day approach – a perfect interim strategy for traders with limited time wanting to gain a feel for the market before giving up their day job.

My daily routine

I trade from home. I work from my laptop, using an extra screen. On one screen I have charts and live prices and on the other I have my own Excel spreadsheet with the day's open and closed positions. I have broadband and cable television connected to the office. I watch bad daytime programming more often than I look at the business channel. The business channel is most helpful before the market opens, when it has a run-down of the US markets and a pre-market summary of the local market. As the morning progresses, the focus on other Asian bourses does not interest me, so I tend to switch over.

The first thing I look at when I turn on the trading platform in the morning is the price action of the Dow Jones Industrial Average, spot gold, and crude oil. I often review positions if I see a big drop in my profit figures during the day. It is common to see a large profit as the market opens and then a fall in this figure as the day progresses.

I watch the charts – the 5-minute and the 30-minute charts as well as the daily charts. Like most traders, I work backwards from longer term to shorter term, analysing the weekly charts first, then the daily charts. As the day progresses, I focus chiefly on the intra-day charts. However, in the last half-hour before the close I check the daily chart again, trying to see how the day is likely to end. Although I am a short-term trader, taking a position for a maximum period of a few days or weeks, I always monitor closing price action. Closing prices are a good indication of how a stock might open the next day. When a downward day closes with a big rally on its highs, it is often a sign that there will be more buying the next day. However, this is not always the case: the close gives a better indication of the future performance of some stocks than others.

When trading gets really boring I lie on the couch in my trading room and watch TV or I go outside to check out the sea, take a closer look at my garden or play with small dog. I generally don't do much – just watch the prices.

I never call my CFD broker if I can help it, but have the number programmed into my mobile phone for easy access in case I am away from my desk. When I'm out of the office I use my mobile data service, which supplies prices to my mobile phone.

* * *

Now that we've covered the basics, we're ready to get started.

Week 1

The first cut

Day 1

Tuesday, 28 June
Total: $12,942

I saw the film *Wall Street* back in the late 1980s and became interested in trading. The Director tells me he too first acquired a taste for trading when he watched the film as a teenager, sitting in a shed in Kerry in his native Ireland. I suspect there are many traders who caught the trading bug that way, in the days when the most famous line from the trading world was, 'Greed, for want of a better word, is good.' The greed is good quote doesn't ring true for most traders, though. In fact, I think the majority would say greed is often their downfall. I have two other favourite quotes from the film. The first is another Gekko saying, 'Greed captures the essence of the evolutionary spirit.' I think greed, the compulsion to make money, motivates us to trade but then leads us to areas of ourselves that we wouldn't normally go to. I think this is the reason why so many traders fail and give up. Lessons you learn about making or losing money can be painful, but the personal lessons you learn sometimes hurt even more. My other favourite quote sums up this phenomenon: the good guy character Lou says, 'Man looks in the abyss – there's nothing staring back at him. At that moment, man finds his character, and that's what keeps him out of the abyss.' There are very few events in an average person's life that will take them to the abyss, but if you trade, I can guarantee this will happen, and if you persevere, you'll find your character.

It all sounds melodramatic, but until you actually start trading you can't understand the enormity of the emotional journey involved. Someone once told me the best traders do it for the self-discovery, not the money. I suppose it's something like that old saying, 'What matters is the journey, not the destination.'

Before I even start my journey, I have to answer an important question: how much should I deposit into my trading account? I ask The Director. 'In general terms, if you want a 20 to 30% return on your money, an account balance of $30,000 to $40,000 would be good,' he suggests. I had thought that average clients started with about $10,000 in their accounts. 'Yeah, about that,' The Director says, 'maybe a little higher, say $20,000.' I set up a new trading account with a fresh balance of $13,000. If you consider that every $1000 is really worth $20,000 or $30,000, because of leverage, it seems like a reasonable figure, and I should be able to make some money from it. I like the number 13.

My first trading day is a Tuesday. I start the morning by checking the local index (the S&P/ASX 200) and the Dow. The local index has not been tracking the recent huge losses on the Dow, which was down 166 points last Wednesday and a further 120 points on Thursday. I take this as a positive. When any market bucks a general trend or a major market or sector trend, it shows its own underlying strength. A large move down in the Dow that is not followed by an equivalent downward move in the local market means that local stocks have more ready buyers, at least in the short-term.

It's not just the relationship between the US stock market and the local stock market that works this way. If a particular stock doesn't move down with its market sector, this often indicates relative strength. For example, if there were a move down in, say, the Australian materials sector index (XMJ), but BlueScope Steel (BSL) stock managed to beat off general index bearishness and make a strong move higher, many market participants would interpret this as a demonstration of BSL's underlying bullishness. This is not always the case, though; sometimes it's a matter of a particular market or stock playing catch-up.

I enter long positions in two share CFDs, both based on a simple break of resistance, one on Aristocrat Leisure (ALL), which can behave like a bucking bull, and one on BlueScope Steel (BSL), one of my favourites. I jump straight into both of these positions. I don't have trouble **pulling the trigger**, but many new traders do. This is normal, and there are a number of things you can do to build confidence. The first is to make sure you aren't gambling. Without a commitment to a trading strategy or approach, your trades are random and therefore tend towards gambling. When you don't have a system you believe in or put on a trade without confidence, you will find pulling the trigger difficult. Committing to an approach you are comfortable with will make entering trades much easier.

I usually risk around $350 on a single trade. I always try to place my stop-loss order at the same time I place my opening trade, because this is when I'm most objective. It makes sense, because the position size is determined by the stop-loss level.

The general rule around the markets is not to risk more than 2% of your total capital per trade. Personally, I generally choose to risk a maximum of $350 per trade. This represents 2.7% of my trading account starting balance of $13,000. If my account balance drops below $13,000, I do not automatically reduce my risk amount. I might have ten trades open at once, risking $350 on each trade. The amount of dollars you have decided to risk per trade will determine the amount you can invest, and therefore the size of the position you can take.

For example, imagine that I want to trade ALL, and that I open a position when ALL is trading at $11.17. I decide that I should exit the position if the price falls below an old chart support level at $10.85, so this is where I place my stop-loss order. The difference between the entry point and the stop-loss point is 32¢. I divide $350 by 32 to get a total of 1093. This is the number of share CFDs I will trade. I round it down to 1000 for the sake of convenience. This approach ensures that I am always trading a position size that takes into account my stop-loss level, my account size and my maximum risk amount.

To summarise, the way I determine my position size is to:

1. identify the entry price
2. identify the appropriate stop-loss level
3. determine the difference between the entry price and my stop-loss level in cents
4. divide my ideal risk amount by this figure.

This tells me the number of share CFDs I should trade – that is, my ideal position size.

Some stocks are more volatile than others, so they need wider stops. If you place a stop too close to your entry level, you don't give the price enough room to move, and you'll find that you are stopped out before you've had a chance to make any gains. However, when you set a wide stop, you should reduce your position size accordingly, to limit the amount you can lose.

When I'm making a decision about how tight a stop should be, I look at a stock's liquidity and what I call charting predictability. I am comfortable taking a bigger position in BSL than some other stocks, for instance, because it tends to be less volatile and more liquid, and it trades more predictably. By this I mean that there are few **false break-outs** on BSL charts.

Day 2

Wednesday, 29 June
Total: $13,145

Before I start the trading day I check the performance of the Dow overnight and recent action of the local index compared with the Dow. I'm looking for anomalies. The Dow and the local index sometimes trade in sympathy, but the Australian market often goes its own way, and this is the case right now. I attribute this current divergence to the recent demand for commodities. Resource-based economies like Australia's traditionally outperform the stock markets of non-resource heavy economies during a commodity boom. This means the local sharemarket could continue to rally at a faster rate until commodities crash.

The time difference between Australia, Europe and the US means that the local market is open at different hours to the major overseas markets. As a result, many of our larger stocks which are listed on local and overseas exchanges 'gap open' rather severely. A 'gap' occurs when a stock opens the day at a price beyond the previous day's extreme; that is, above yesterday's high for an upward gap, or below yesterday's low for a downward gap.

BHP Billiton (BHP) and Rio Tinto (RIO) are prime candidates; they often move further up or down on a gap open than they do throughout the rest of the Australian trading day. This can make trading these stocks difficult, and discourages me from trying. Gaps on the open can happen to any stock, but some gaps are so common and so large that they make your best technical analysis-based trading useless – the distance you could normally trade on a short-term basis is swallowed up in opening gaps. Traders with a longer term perspective, who hold positions for weeks or months, would be less discouraged by gaps, as they are less concerned with short-term volatility generally.

A significant move higher on the Dow generally helps our local market rally. The Dow made a triple-digit move higher last night; looking at the local share charts it seems that the Australian market was already anticipating this upward move.

Being a break-out trader means that I prefer to buy as soon as the price of a stock exceeds recent or old highs. I learnt early on in my futures-trading days that a stock is never too high to buy or too low to sell. When a strong bull market is happening, you can forget about ‘buy low and sell high’ – that’s a pipe dream. It’s a case of getting on the bus and not worrying whether you get the front seat or the back seat. The longer you’re in the trading game, the more you’ll understand that the important thing is not your entry, but your management of the open position and ultimately your exit.

For this reason I rarely use a limit order. Instead I enter at market and, unless there is a big gap in price between the break-out level and the current bid or offer, I accept the market price. If there has been a significant jump away from the break-out level I might keep my finger on the trigger and wait until the volume returns to the market before I open a position. Pulling down the price depth window on my trading platform keeps me posted on the available volume.

Sometimes a stock breaks a key level at or near the open of the trading day and then pulls back. I’ve seen this happen many times with BSL and often wait for it to complete a pullback before I try to buy.

This morning, BSL gaps open and then rallies above its recent high of $8.36, which happened on 20 June. I decide to go long for another 2000 BSL and my order is filled at $8.39. It tops at $8.40 and then starts to fall again. Figuring that a close below the day's gap open price would be a negative, I cut the whole position at $8.30. I more or less break even on the cumulative position.

If a stock I'm trading does not behave the way I expect it to, it's usually a sign I should get out of the trade, even if I haven't made a loss on it – unless of course it runs into a much bigger profit much faster than expected. If I buy on a break-out near the start of the day and then the stock goes back down, a move below the day's low is usually my sign to exit. This is because a test of the upside has effectively failed and a test of the downside is now on the cards.

Newcrest Mining (NCM) is a stock that often has a very thin order book (limited liquidity), but I'm a sucker for big ranges, and NCM can move more than $1 during the course of a trading day. This stock also trends nicely, which offsets the relative illiquidity. It might typically trade a **spread** as wide as ten or fifteen cents, especially after a key support level or resistance level has been broken. This stock can really move, so I rarely wait for it to narrow the spread before I jump in.

I see NCM take a fall and then rebound just as fast. With the price of physical gold down US$4 overnight (physical or 'spot' gold is always quoted in US dollars), the obvious trade was on the short side, but the obvious is often a trap.

If NCM closes below $16.50, this will be a break of major support and confirmation of a topping pattern. The downside test takes it to $16.58 before it rallies hard. Because NCM is a thin stock, its price can be pushed around and there are always plenty of false break-outs. I get set for a long position at $16.77, a price which represents the first break of resistance since the $16.50 downside was tested and rejected. I watch the stock pull back and then buy some more when it goes above the pullback high of $16.93. My total long position in NCM now is 2000 share CFDs.

I go to lunch and come back to discover the stock's been all the way up to $17.09 and then fallen back below $17.00 again. It has done exactly the opposite of what I had anticipated earlier in the day, when I decided to open the first long position. It has made a quick move higher and just as quickly retraced those gains. I've missed the cue, so I work a stop at $16.89. I base my stop-loss level on a recent resistance level that I expect to turn into a new support level.

It is not until the end of the day that NCM reaches my predetermined stop level. I take the whole position out at the close. This is not always the best time to trade, because prices can be very volatile in the last few minutes. The Director says that, on average, 30% of the day's business is executed in the last ten minutes of trade. I ask him about other Aussie share CFDs that can be extra volatile into the close, and he mentions ARC energy (ARQ), Brickworks (BKW), CSL Limited (CSL), St George Bank (SGB), Perpetual Trustees Australia Ltd (PPT), Cochlear (COH), Macquarie Bank (MBL), Sims Group Ltd (SMS), Publishing and Broadcasting (PBL), Caltex (CTX), Rio Tinto (RIO), Woodside Petroleum (WPL) and Wesfarmers (WES).

If you are trading long-term, liquidity on the close is not as important, but because I tend to hold positions for the short-term, building a position over a few days or a week or two at most, the need to exit or enter on the close is high and therefore I need to take closing volatility into account. CTX is the only stock on The Director's list I usually trade.

One of my daily habits is to check the market action 'into the close'. If it seems likely that a stock's movement will finish strongly, taking out recent resistance levels, I am often encouraged to enter a trade before the market closes. I like this entry technique because a stock with this kind of price action will often gap open the following day.

Today's end-of-day run-down leads me to take two long positions into the close.

My first long position is Excel Coal (EXL) for 1500 at $7.57. EXL gapped higher on the open this morning and then rallied throughout the day, breaking out above its resistance level at $7.57. This resistance dated back to 23 June and had been tested and rejected on the daily chart on each of the subsequent trading days. The more often a level is tested and rejected, the more significant it is when the price finally breaks through. EXL settles the day at $7.60, which means I'm three cents in the money.

The other trade I carry out near the close is in Jubilee Mines (JBM). I buy 2000 at $7.07. JBM makes a similar pattern to EXL, closing above its 23 June high for the first time. It finished the day at $7.12.

Day 3

Thursday, 30 June
Total: $12,764

I didn't sleep well. Small dog woke up three times in the night, once to sit by his food bowl and cry. He's never done this before. I'm superstitious, so I take this as a bad omen.

Before the session starts I check my open positions and make sure stops are placed on everything. I place a stop on Excel Coal (EXL) based on an intra-day support from yesterday's chart. I also place stops for Jubilee Mines (JBM) and Aristocrat Leisure (ALL) based on previous intra-day support levels.

At the beginning of the session I am stopped out of two of the three positions I have open. The first one is ALL. Being stopped out too early and watching the trade go back into profit is more painful – much more painful – than getting stopped out on an ordinary losing trade. I moved my stop-loss level up, making it extra tight. If I had left it where it was originally, it would have kept me in the trade. I make a $10 loss. When I'm not making money generally, these kinds of events have more impact on me. When my account is riding high, they don't matter. I'd like to get to the point where, win or lose, the profit or loss from a trade never matters. Ashley J says opportunity cost cuts deeper than the normal loss – when a winning position is not taken, it causes more regret than a position which is closed out for a normal loss.

EXL goes as low as $7.39 and I get stopped out at $7.47. I'm getting chopped up – getting stopped out or 'hit' going long or short – because the market is rangebound. I was hoping that once I started writing the trading diary I would make money right off the bat, but that isn't happening. Just as markets trend, so can your profits or losses. I fear that I have started off in loss mode and that this might be a trend that has some course to run.

Maybe part of my problem is entering on daily close data, but working stops based on intra-day data. I do this as a way of circumventing my $350 rule. When I see a good trading opportunity based on a closing price, I tend to work a stop-loss based on an intra-day level. This is because a closing price entry is usually a long way from closing price stop-loss levels. Setting a stop-loss level in this way is essential for a longer term trading approach. In order to take such a trade over the short-term prudently and with discipline, I would have to take a much smaller position size, but this kills the fun, so I tend to work my normal size position but use a stop based on a 30-minute chart. This is clearly tempting fate: an entry based on an end-of-day signal often needs more room than one based on a 5-minute or 30-minute chart entry signal.

Every successful trader will tell you that the only way to trade any kind of market successfully is to have the right psychology. I used to read a lot of books about positive thinking, but they aren't helping me now. I decide to take a more drastic measure. Years ago I read about a technique called neuro-linguistic programming (NLP), a way to reprogram the brain. I decide it is worth a try, and I search the net for an NLP therapist. I find a woman who does both hypnotherapy and NLP.

I go to my first appointment hoping I can turn my new losing streak into a winner as quickly as possible. I expect to be on the therapy couch, listening as the therapist tells my subconscious that I am a happy trader, enjoying abundant wealth and success, but instead she's dragging up the past. Parents, ex-boyfriends, flatmates, anyone who has had an influence and contributed to my negative thinking. I cry, but she tells me this is normal. She ends up presenting me with a bunch of negative statements – damaging beliefs about myself – that affect the way I see things without me even knowing it. The plan is to start to reprogram at my next session, replacing the old negative statements with new, positive ones. She assures me it's not like traditional therapy, in which it takes years to work through your issues. The idea with NLP is to identify the negative selfbeliefs and then start changing these unconscious thought patterns in order to stop making the wrong choices.

Day 4

Friday, 1 July
Total: $12,069

With the Dow down nearly triple digits this morning, I expect some of my stops to get hit. Spot gold was also down, so my small long position in Newcrest Mining (NCM) is likely to be stopped out on the open, given the stop-loss order I left in place yesterday. Gold stocks don't always follow the index lower, but I check on my trading platform. The US gold share index is down just under 1%, and NCM follows suit, falling around 15¢. The stock opens down on yesterday's close and continues lower. I work a tight stop and lose less than $200.

I see Centennial Coal (CEY) test the upside and meet resistance at the highs of the last two days. I take this as a negative, so I take a short position. I am wrong. The price rallies and I'm taken out on my stop-loss before the end of the day.

I also take a short in Computershare (CPU). I've been burnt by placing too tight a stop on this stock before, so I drop my position size to take a wide stop. I go long Patrick Corporation (PRK) after it breaks a basing range. I place a stop under the basing range.

All of the positions I've taken so far were made on the basis of easily observed support and resistance: I worry that perhaps these trades are too obvious. I keep thinking about a comment from The Director that the smart money does not think like the crowd.

They say you should be thankful when your first trades are losers, because this teaches you a greater respect for the markets from the beginning. If you have already started trading CFDs and your first trades were losers or you've had a losing streak, you should be able to relate to the experience I'm having now. If you have been trading for a long time, you know that losing streaks can last weeks or months and getting back into a winning phase might mean adjusting position size, working smaller stops, taking fewer trades or not trading at all for a while. One thing's for sure, getting back in the zone takes a mental/emotional shift.

The story so far

Profit/Loss to date – $931 loss
Closed positions – 10; Open positions – 4
Winners – 3; Losers – 7; Win/loss ratio – 0.30
Biggest loss – $287; Biggest win – $203
Number of consecutive losing trades – 5

Not a great start. Five losers in a row is a tough beginning emotionally. Biggest losing trade is larger than the biggest winning trade, which isn't a good sign either. Win/loss ratio not great. My obvious problem is that I'm setting my stop-loss levels too tight. This is a common error made by new traders. It inevitably leads to the use of stops that are too wide; traders overcompensate, going too far in the opposite direction, and incurring bigger losses as a result. Also, I must make use of lunchtimes to grasp profit-taking opportunities and adjust stop-loss levels.

What have I learnt?

- If I use closing price data to enter a trade it follows that I probably should use closing price data to plan my stop-loss levels. Instead, I have been using intra-day data. I need to consider my late-in-the-day entries in light of this and maybe reduce my position size, since it is resulting in me getting hit on too tight stop-loss levels.
- End-of-day volatility needs to be considered. Big swings in the last few minutes are the result of heavy volume as traders re-position themselves into the close. For short-term traders, the volatility some stocks show in the last ten minutes of trading is too great, so it might be a good idea to avoid trading them altogether. (The stocks The Director listed for me are good examples.)
- Watching as a position is stopped out and then seeing it go back into profit is very painful. I have to combat this feeling and be prepared to enter again.

Do's and don'ts

- Do have the right psychology, because it is everything. If you are new to this game, I know you won't believe me, but the sooner you grasp this concept, the faster you'll become a consistently successful trader.
- Do be thankful for your losing trades, especially in the beginning. They are your most important trading lessons.
- Don't start trading until you have a plan, even if it is something as simple as entering on a particular pattern or indicator and exiting with a trailed stop-loss order. Trading without a plan is just gambling.

Lingo and lessons

Trouble pulling the trigger?

The opposite of impatience is not being able to pull the trigger: waiting too long to enter a trade. This happens to me when I'm in a losing spiral – I tend to stay out of good trades when I feel that I can't stand any more losses. My trading coach has a simple solution for not being able to pull the trigger, an approach that is especially well suited to CFD trading because the commission rates on CFDs are so low. He recommends taking small trades on which you will pay a maximum of $10 in commissions, and then simply buying and selling until pulling the trigger ceases to be an issue. This might mean holding a position only for a few minutes and then getting out. The idea is to get accustomed to the entry and exit procedures, diminishing the fears associated with the trading process.

False break-out

A false break-out occurs when the price goes beyond a support or resistance level, confirming a break-out, but instead of following through, it retreats back inside the break-out point.

Spread

The distance between the highest bid price and the lowest offer price is called the spread. The wider the spread, the higher the cost of trading. For example, assume that the last traded price on Aristocrat Leisure (ALL) is $12.50, with a current bid price of $12.40 and an offer price of $12.55. This is a 15¢ spread. If you were to go short at $12.40, you would be selling at 10¢ below the last traded price, and the stock's offer price would have to fall to $12.40 before you could buy back and break even on the trade. If we imagine instead that ALL is trading a narrower spread of $12.49–$12.50, anyone deciding to sell at market would be set at $12.49. That's a 9¢ improvement on the wider spread quoted in the first example, and the stock's offer price would only have to move down 1¢ before the trader would break-even. Always consider your break-even price before entering a trade. You will find a more detailed discussion of spread in my first book, *Contracts for Difference*.

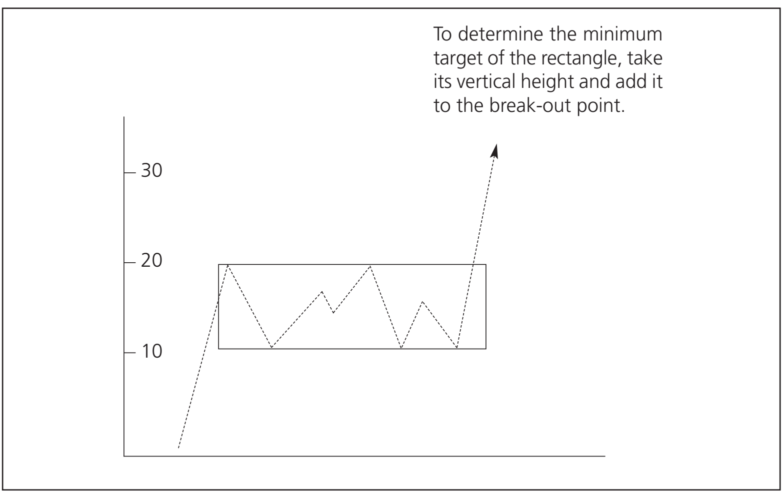
Targets for chart patterns

A 'target' is the price you expect a stock to achieve or fall to following confirmation of a pattern.

Once there has been a break-out from a pattern, the target – that is, the minimum distance you expect the price to travel from the break-out point – is determined by taking the vertical distance or height of the pattern and adding this distance to the break-out point for a bullish break or deducting it for a bearish break.

To determine the minimum target of a rectangle, first calculate the vertical distance between the base and the top of the rectangle, and then add this figure to the break-out point. For example, looking at figure 1.1, you will see that the value at the base of the rectangle is 10 and the value at the top the rectangle is 20. You would subtract 10 from 20 to find that the vertical height of the rectangle is 10. When you add this to the value of the break-out point, 20, you will arrive at a minimum target of 30.

Figure 3. Determining targets for chart patterns

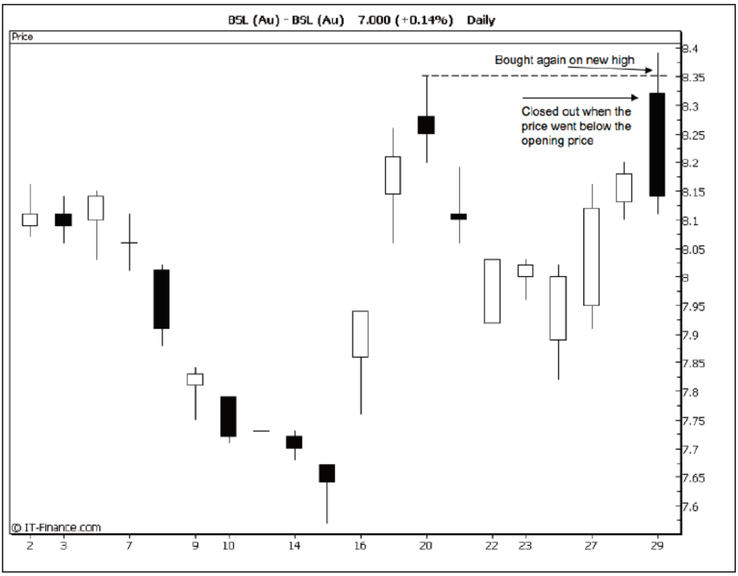


Trading tip no. 1

Stop-loss level based on the opening price

Old chart highs are significant. A strong close above an old chart high is a buy signal; however, if a stock breaks resistance intraday, but can't go higher, and then starts to fall back, it's a sign of underlying weakness.

The chart below shows price movements for BSL throughout June 2005. I was already long 2000 BSL share CFDs when the market opened on 29 June. I bought another 2000 parcel near the open after it gapped. However, there was no follow-through, so I worked a stop-loss order for the total amount just under the gap open. The price moved down, fell below the gap open, and continued to fall. When there is a gap open to the upside and a rally, a good point to place the stop-loss is just under the opening price.



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