Mindful Trading using Winning Probability

Hello and welcome, below is the chapter index for the book.

Scroll down for a short example piece of each chapter.

Chapter Index:

Introduction

The 2 main reasons traders don't make money from the market:

1/ they don't have a system or method to trade   (Knowledge)

2/ even if they do have a method, they don't stick to it   (Psychology)

Ask yourself honestly - have you employed a method in the market (without constantly changing it) and stuck to it for a period of time to enable you to review your technical and psychological performance?

Often the reason traders don't stick to a system is that the system they have is either too difficult or they do not know the historical performance of the method they employ. Once they realise this and seek to rectify that issue, be that issue technical or psychological, they have made a quantum leap in trading mastery and the real trading and investing journey begins. In my opinion the biggest killer of trading success is stress and worry. We all entered the markets in the first place with the intention to improve our lives through financial independence, not to make life more challenging than it already can be. Stress and worry is brought about through uncertainty, as well as a healthy dose of past trauma experienced by many as a result of the global financial crisis (or in fact any loss)…………………………………..

Chapter 1: Objectives

In my opinion all method creation or choice of a method starts with an objective. The objective needs to be clear and defined. In this circumstance the objective is to create a method which returns between 25-30% p.a. The method will do a minimal number of trades, focus on holding medium term (weeks to months) to long term (months to years) trades, incur minimal brokerage expenses, have a level of drawdown (portfolio pull back) that is psychologically manageable, have a reasonable win rate and minimal number of losses in a row.

The system is designed for people who are either time poor, or do not want to be looking at or analysing the market and their portfolio on a daily basis. It is also designed to minimize work, trades, decision making and to maximise the benefit of medium to longer term trends from stocks. One of those benefits is a reduction in tax liability, one of the big benefits of medium term systems rarely discussed. One of the main reasons a buy and hold strategy can work well for some is the simple fact that the trader/investor does not over trade. One of this system's objectives is to trade frequently enough to benefit from the strategy of having your money in the best place at the best time, without over trading and causing excessive stress to the trader……………………………..

Chapter 2: Explanation of Moving Averages

This section is for those with little or no charting experience. Moving averages will be explained using simple charts of stocks. The chapters to come in the book will show chart examples and discuss entries and exits using moving averages, so it is imperative you understand what they do and how they work. Intermediate or advanced traders and investors can most likely skip this chapter. Although brushing up on simplicity never hurts……………….

Chapter 3: Rules of the Method

This is a trading system with set rules**. A distinct feature of this method is that there is absolutely no discretion in what it buys.** The entry rules have to be met by the particular stock before it becomes a valid signal, and there is only one possible buy or one stock that meets the criteria each time. **This allows the trader to know exactly what to do to.** It is a set process to follow. There is no subjectivity to confuse the trader.

This set process also allows the trader to revise accurately. One of the main reasons for trading failure is that traders do not revise their trades and decisions. Having a methodology with set rules strengthens the process of revision. Rules enables one to measure accurately the systems performance and seeing clearly where the operator is not sticking to the rules…………………

Chapter 4: Rule 1 - The Bull Filter

When markets are going up they are considered to be in a Bull Market. When markets are going down they are considered to be in a Bear market. Our first step is to choose a method that reflects the trend and the health of the market, for we do not want to buy in a down trending market.

The best way to determine if the market (XAO) is rising and in our favour, is to use a filter that tells us if to buy or not…………………………………

Chapter 5: Rule 2 - The Entry

One of the biggest mistakes traders make is they do not buy stocks in up trends. Stocks that are trending for a period of time have a greater probability of continuing that performance and producing a winning trade.

This buy signal used in combination with the Bull Filter gives us a good chance of putting odds in our favour. We want our stock to rise over time. Buying a rising stock in a rising market is what I mean by odds in our favour………….

Chapter 6: Rule 3 - Buy low price stocks

It's a common question and a good one. If you have money to buy a stock to add to your portfolio and there is more than one stock making a 52 week highest close that week, which one do you buy? But it is better still to ask the question, which stock gives you the best probability of a winning trade?

To answer that question, I have used the system to test the profit and loss probability of different priced stocks using a 'flat' position size of 5K per trade. A flat position size means every trade taken is fixed at 5K. Testing was based on the ASX 300 over a 10 year period, from the results of over 1000 trades…………

Chapter 7: Rule 4 - The Exit

What exit you use for your trade is one of the most important. In fact with most systems, exit is far more important than what the entry is. Traders and investors worry and over focus on WHEN to buy, but nearly all portfolios can be improved with a GOOD EXIT.

The exit determines very important factors such as:

1/ the ……………

2/ the ……………………..

3/ the average win of your trades

4/ the number of …………………….

5/ the amount of drawdown (pullback) your portfolio will have.

6/ the………………………..

7/ the number of wins in a row the system has

8/ the…………………………………….

The exit is the **big influencer** on the system. Learning to trade the market is about give and take, no system is perfect, but it could be perfect for you. If choosing an exit influences so much all the above points then what is required is to get back to the objective in weekly trend trading which is……………………………..

Chapter 8: Rule 5 - Amount of capital allocation to each stock

To keep things simple and as easy as possible for the operator (you) this system uses……. of portfolio capital per stock.

Chapter 9: Review of the rules

A complete review of the 5 rules and what to look out for……………

Chapter 10: Statistics of the system

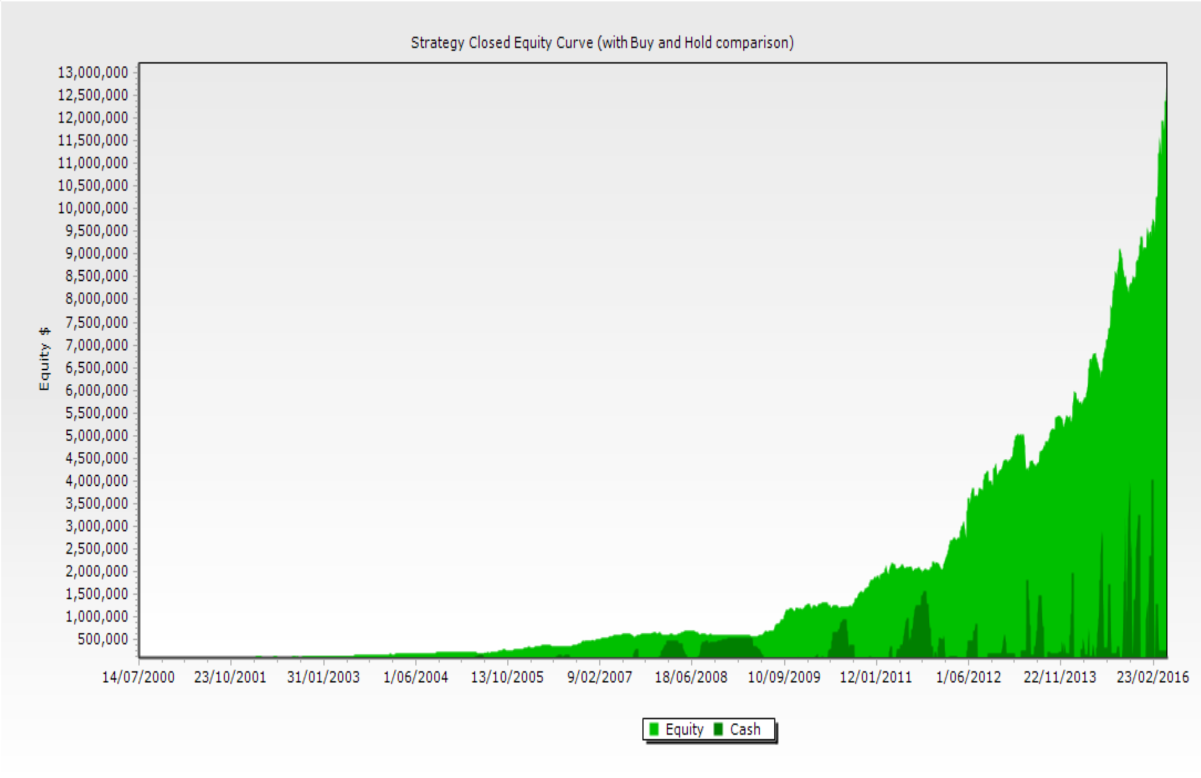
The next part of this book discusses statistics and results of the system over different time periods. **This is the number crunching part of the book and some of it gets a bit heavy. No doubt some of you will hate it and others love it.** The idea of examining different tests over different time frames is to highlight to you the best and worst of this method.

These statistics will be important for those with an analytical personality, as it is imperative to use statistics to understand the probability of the method being used. However, perhaps a more important consideration is **to look at these numbers from an emotional perspective**, continually asking the question: "Can I trade this method?"

Remember what I claimed to be the two big problems with most traders and investors?
No method and no commitment to a strategy.

Commitment to a strategy is easier if you fully understand what the worst case scenario could be, so you are emotionally prepared when the portfolio gets volatile and pulls back from its equity highs. Portfolio pullback is for most traders the most challenging emotional experience.

Below: a long term equity curve of the system



Chapter 11: Monte Carlo

Two traders can adopt the identical system, like the one in this book, but get different results. If our two traders start their portfolio one week apart, obviously they are going to be holding different trades, over time their portfolio content may vary considerably. Also perhaps one trader delays on a either a sell or a buy signal, therefore missing a signal and not buying a stock that the other trader would. In fact the variations over time between portfolios can become endless.

So the question is how do we truly estimate what the average return from a method will be? The answer is Monte Carlo software. For what this clever piece of technology does is take every possible trade taken by the system, randomise the start dates and then calculate the average return.

In the graphs and stats below Monte Carlo has taken all the trades from our method, over the last 6 years, altered all the start dates, **simulated 1,000 portfolios and averaged the return…………………………**

Chapter 12: The Pareto Principle

Originally, the Pareto Principle referred to the observation that 80% of Italy's wealth belonged to only 20% of the population, and is attributed to economist Vilfredo Pareto. More generally, the Pareto Principle is the observation that most things in life (effort, reward, and output) are not distributed evenly.

What has the Pareto principle got to do with this system?

I am sure many of you have heard the trading saying "let profits run, cut losers short".

Do you know the reason why?

Chapter 13: Commonly asked questions

Example of some of the questions asked that are answered in the book, there are many more.

So therefore what is a solid test over the long term and how does one reduce bias as much as possible?

Do you use a fixed stop?

Why not just buy the crossover?

If I get a signal during the week do I sell?

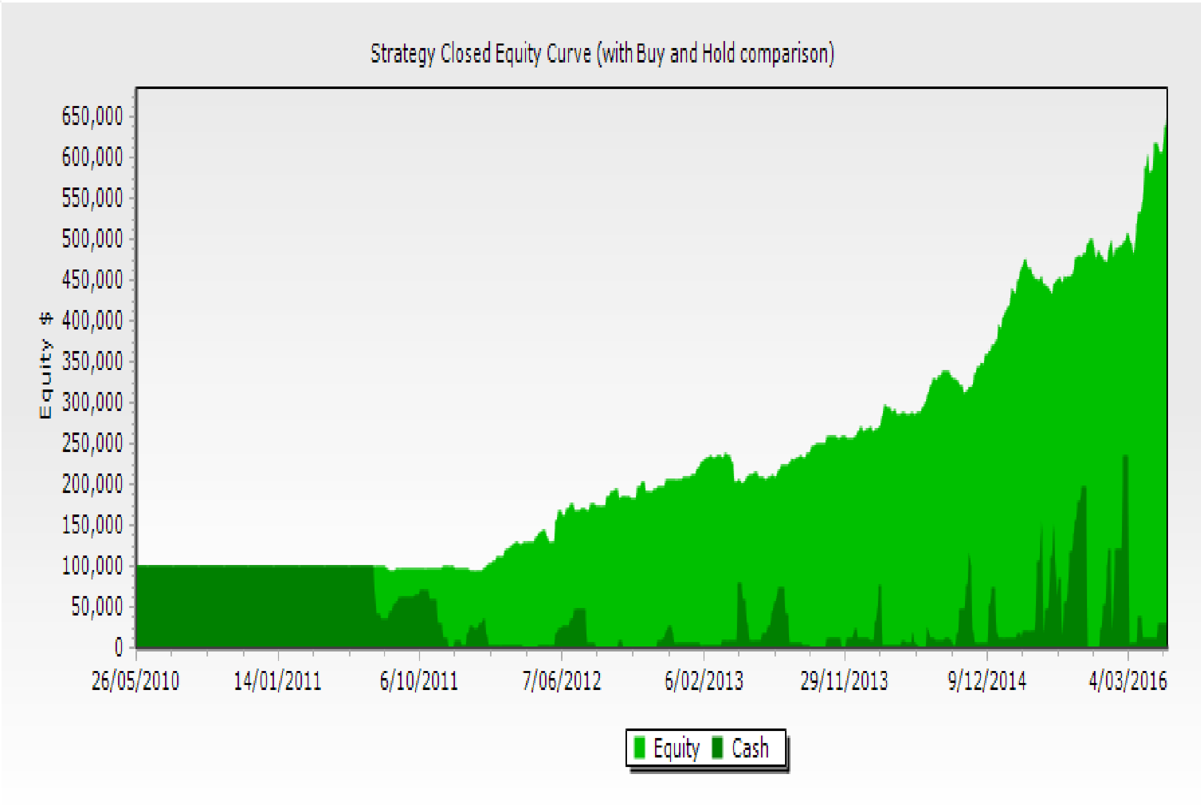
Do you use turnover or liquidity filters?

Does the testing include dividends received?

What about recent performance?

Example answer: I feel that the most recent trading period is more relevant, so below is the last 5 years on the ASX 300.

Good trading is about good execution, sticking to the plan. Not over trading and/or grasping for ideas or changing the plan when you feel like you are drowning in a sea of emotion. If you are drowning in a sea of emotion you are probably over trading, don't know what your odds are or have too much money invested for your emotional tolerance. Perhaps all of those reasons is why you are struggling.



And many more questions answered with graphs, statistics and trading experience.

Chapter 14

Where to start and final suggestions, with tips on the following

Internet brokers

Charting

Software, signals and back testing

Patience

Meditation/Zen

If losing. Stop Trading?

Contracts for Difference

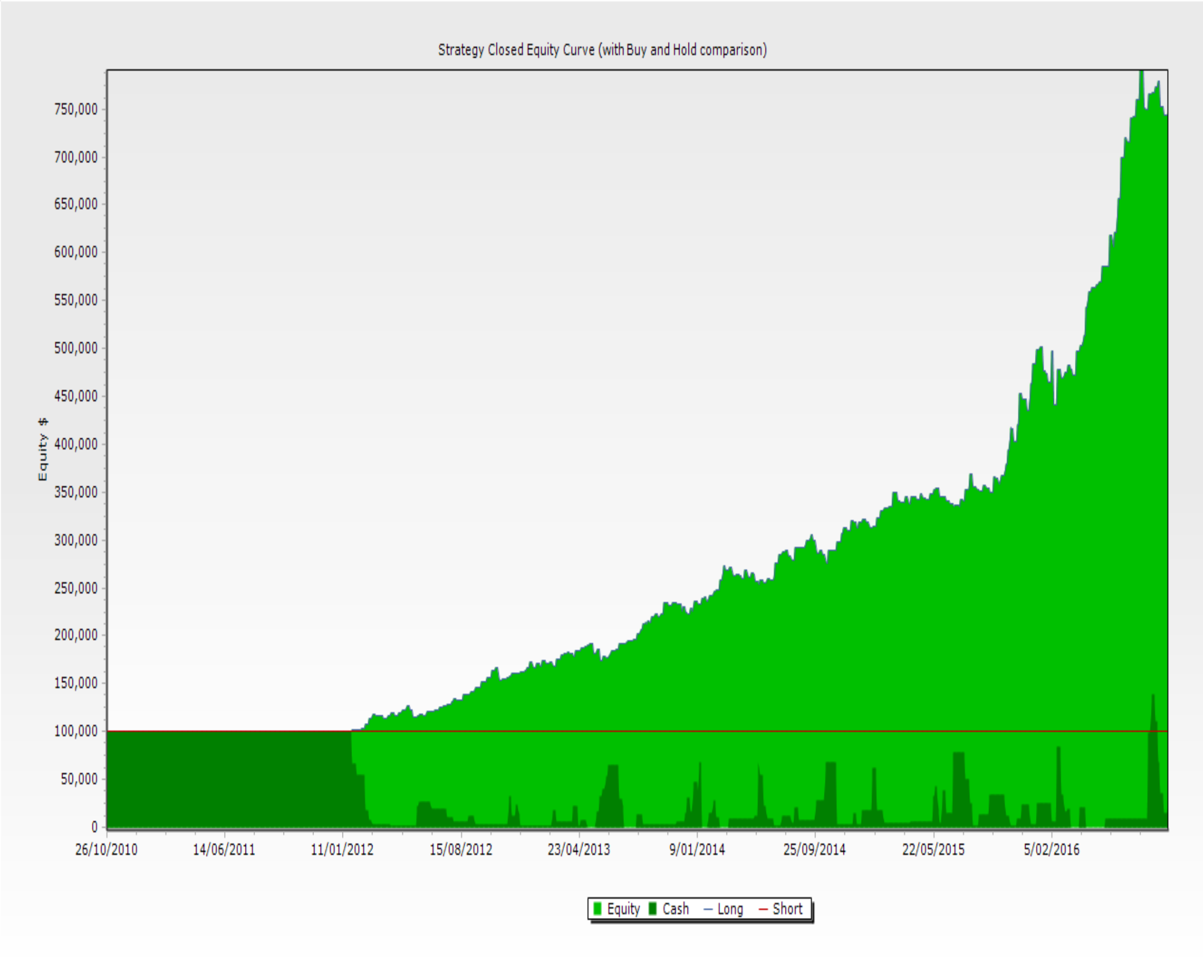
Personal coaching (what I teach)

then finally……….

Alternative systems, advanced trade sizing, other entries, other exits, momentum criteria, pyramiding, choosing fundamental stocks and more.

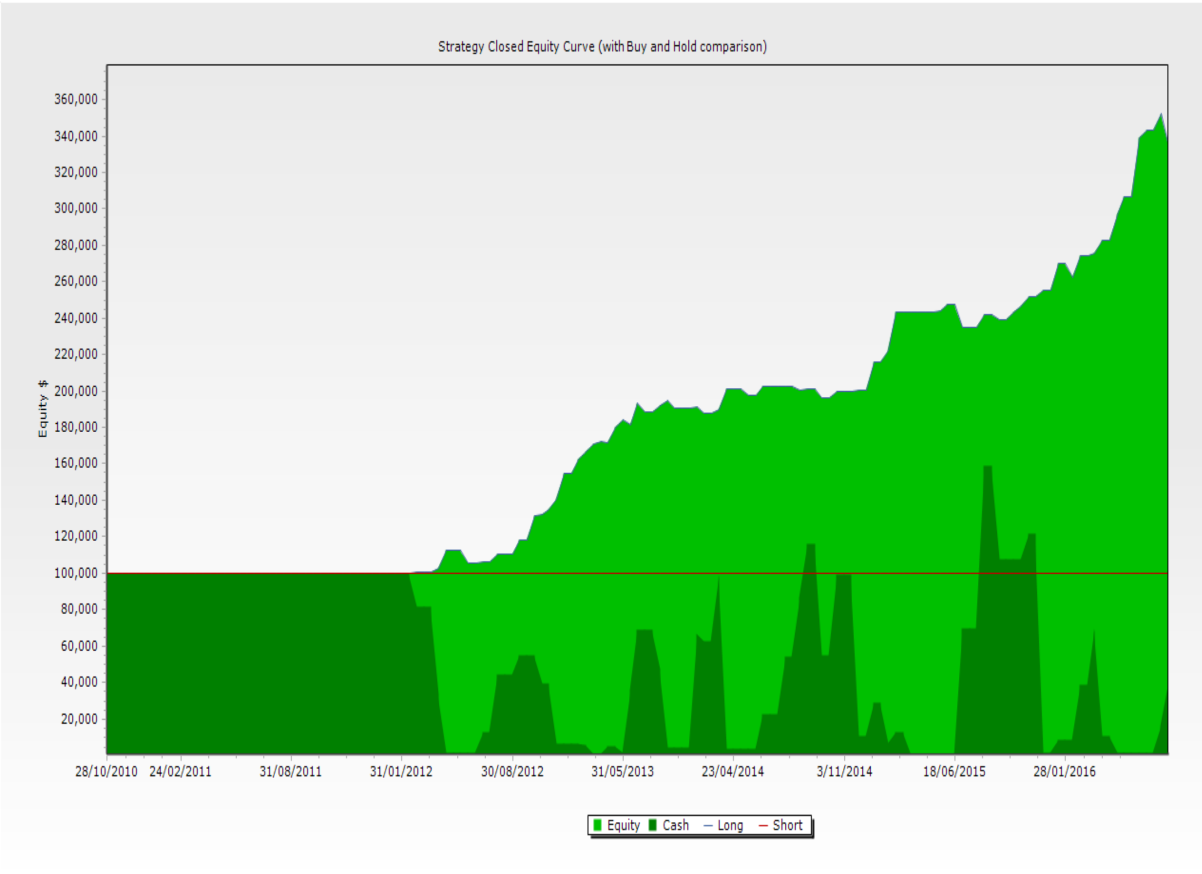
The system in this book is very simple……..more advanced methods available

For example, below are the results from a more advanced system traded on the ASX



The system has a 68% win rate, averages 20 trades a year and an almost 50% p.a return. This test is a little later than the ones displayed previously in the book, being done late October 2016.

For the DIY (or professional) superannuation fund manager, below is an example of a more conservative system. The big feature of this system is it trades on a monthly time frame…………



This system has done just 65 trades in 5 years (13 a year) has a win rate of 57% and has returned an average of 28% p.a. A portfolio trading this system would hold an average of 10 positions. This test was also done late October 2016.

Some reflections about trading for a living

Being a full time trader is at times a difficult occupation, so if that is your goal do not take it lightly. The example and testing I have shown you don't include dividends because I don't consciously look for them, my objective is capital return. I receive enough money per year from dividends to pay my brokerage, plus other costs like……

The health consideration of trading as a business is not to be under estimated…….

If you want to trade short term make sure you have a great system or it just isn't worth it.

Longer term methods arguably have a disadvantage of being "in the market" most of the time, but this can also be a big advantage at times………………

Treat trading like the business it is, not like a flutter on the horses. You wouldn't go into any other investment or business with solely that attitude, but as we have all seen, traders do it all the time!

Don't be one of them and put more probability in your favour.

I appreciate your purchase of this book and hope that to some degree I have either restored the faith, re lit the enthusiasm or ignited the passion you have for trading.

Regards

Peter Castle