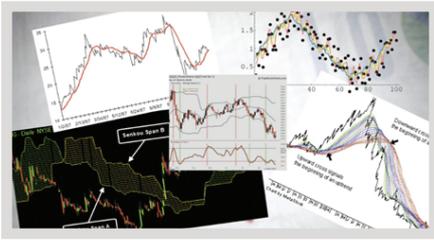


The 3 Forex Strategy CORNERSTONES

CORNERSTONE #1

GET STARTED



Despite what most starting-out traders might identify as the reason why they haven't actually gotten stuck into Forex, a lot of the time the real reason – is Choice Paralysis.

There is simply too much to choose from: timeframes, styles of trading, indicators, scripts, etc. When you have so much choices you can either get lost and not know where to start or might find yourself not being able to commit to one strategy jumping around looking for the best option.

In either case, the outcome is the same: no defined trading strategy and no consistent trading style. Needless to say that destroys any desire to continue trading. What's the answer?

JUST GET STARTED!

To make it easier for you, we've broken it down into steps:

- STEP 1** Choose a market movement you want to hunt for:
- Trend
 - Flat
 - Retracement
 - Impulse
- STEP 2** Choose how often you want to trade:
- Buy and hold
 - Intraday
 - Swing
 - Scalping
- STEP 3** Choose a tool. Pick one you like or you're curious about – doesn't matter. Pick one and stick with it. Here are some powerful ones I like:
- Simple Moving Average (adv. version: SuperSmoother)
 - Support & Resistance lines
 - Channels
 - Triangle Patterns
 - Fibonacci Retracements (adv. version: Harmonic Patterns)

NOTE: These are just some tools to help you avoid choice paralysis. If you like something else, that's totally fine too.

STEP 4 Write it down. A good trading strategy needs to be written down. Yes, with good'ol pen and paper. That will help you keep disciplined about your trading.

STEP 5 Explore! Now that you've made your choices, forget that you have other options available to you and commit to what you have selected. Don't worry, if you find that you don't like what you have selected you can always go back later and change your pick. But for now, it's time to move forward. Of course practice on a demo account, but the point is to spend some time to intimately get to know your to-be-trading-strategy.

TEST AND ITERATE

There's a phrase "number game". At ForexBoat we don't like to call trading a "game", because it's not a game – it's a profession. However, the essence of "numbers game" applies to Forex well. How can you determine that your trading strategy WILL BE profitable? You can't! It's simply not possible.

What you can do, though, is assess the probability that your strategy will keep making profits from a statistical point of view. People often get frightened when we start talking about a "statistical point of view" or "statistical confidence". But it's not rocket science. It's all logical straight-forward stuff. Let's have a look.



Here's an example: let's say you developed a trading strategy and you checked 5 of its trades in past 3 months (note: it's not that the strategy would have done only 5 trades – that's just how many you checked). All 5 were profitable. So that's 100% profitable trades. Question: even if market conditions hold constant for the next 2 months, what do you think are the chances that your trading strategy will continue to have 100% profitable trades for those two months? More importantly, how statistically confident are you in this result? Not that much, right? After all, your sample size is only 5 trades.

Now, a different example: you developed a different trading strategy and this time you checked 130 of its trades in the past 3 months (that's about 2 trades per business day). Out of them 90 were profitable. So that's about 70% profitable trades. Question: if market conditions hold constant for the next 2 months, what do you think are the chances that your trading strategy will continue to have 70% profitable trades for those two months? More importantly, how statistically confident are you in this result? It's not a certain thing (nothing is ever certain), but you feel a bit more confident, right?

That's what statistical trading is all about.

Cornerstone #2 is all about testing and iterating your strategy. This means sitting down for a few hours several times a week and putting in the work to run those tests, to observe market conditions, to grow your sample size, to adjust what you don't like about your strategy.

To help you on this journey check out the following tools:

- Forex Tester 2 (for manual trading speedy backtesting), and
- Birt's Tick Data Suite (Optional. Complex. Add-on for algo trading optimization)

See www.forexboat.com/tools for links.

ASSESS AND MONITOR

Finally, a point so many people miss out:

FOREX STRATEGIES DETERIORATE OVER TIME

Nothing lasts forever. This includes Forex Strategies. As time passes, market conditions change and what used to work well starts performing “fine” and then it starts barely breaking even and then it falls off a cliff.

That is also the answer to the question why at ForexBoat we don’t just give out trading strategies for traders to go and make money. Because it doesn’t work like that! Forex Trading is hard work (albeit it can be very rewarding) and strategies need taking care of even after they have been developed and are put to use.



So how do you monitor a trading strategy?

Again the answer is statistically*, and again it’s not rocket science. Let’s have a look.

*NOTE: There are different schools of thought around this. At ForexBoat we try to stick to this one.

First things first, if you have some trading history in your terminal – right click on any trade and select “Save as Detailed Report”. Find that report on your hard drive and open it.

There are lots of number in that report, but the main ones we are after are:

1. Number of trades
2. Expected Payoff
3. Profit Factor
4. % Positions Won
5. Relative Drawdown
6. Recovery Factor

Number of trades – as discussed in Cornerstone #2, we want this number to be such that you are comfortable feeling that your profits are not just a random chance. That the overall performance is likely to continue in the immediate future.

Expected Payoff = Net Profit / Number of Trades. How much on average the strategy earns per trade. This parameter can be manipulated if the lot size is changed, so there is no specific value to aim for. As long as it’s above zero.

Profit Factor = Gross Profit / Gross Loss. How many dollars you make per every dollar you lose. From the definition we can tell, that if $PF < 1$ then the strategy is losing money, if $PF = 1$ – it’s breaking even, and if $PF > 1$ – making money. Obviously, we want $PF > 1$. Some traders aim for 1.2. At ForexBoat we find that’s not enough and we aim for 1.6. Why? Because we want to create a buffer so when the strategy starts deteriorating we can notice this before the PF gets to 1. If you start with $PF = 1.2$ you are much more likely to only notice deterioration when PF falls under 1.

% Positions Won – Some people find this parameter important and aim to maximize it. Ultimately, it depends on your TP / SL ratio. If on average your trade brings you 2x profit than loss, then even 50% positions won will make a winning strategy. At ForexBoat all we are concerned about is that % Positions Won x Number of Trades is substantial. I.e. that we have enough profits in our sample. So it's not just 1 or 2 huge profitable trades versus 100 losses. Because what happens in that scenario if the profit doesn't come next time?

Relative Drawdown – we are looking at the % figure. And again, this is a parameter that can be manipulated by changing lots. As long as you have your lots calculated appropriately and you are comfortable with the size of your position, a good ballpark for RD is about 15% maximum. Some are more conservative and look for 10% max.

Recovery Factor – aha! This one is not in the report! No worries, you can derive it on your own. The formula is: $RF = \text{Net Profit} / \text{Max Drawdown}$. Here Max Drawdown is in absolute terms, not percentages. Just as with the Profit Factor we aim for a certain level of the RF. That level is 2.0.

This brings us to the ForexBoat stability criteria:



Note that these are just our guidelines. You should develop your own preferences based on your risk tolerance, trading style and financial situation.

Once you have your stability criteria, observe your strategies and monitor their performance.

Good luck!