

The Trading Plan

I have been asked by a reader to comment about developing a trading plan. This prompted me to recall the old quip: “How do you make God laugh? Answer: Show Him your plans!” Insert the word Market instead of God and you have a good idea about how many relate to the market. Either they don’t have a plan and consequently lose or their plan is not capable of producing a profit. There is further sad fact that surrounds the issue of trading plans: people find the systematic and faithful implementation of their plan extremely difficult. Their own psychology gets in their way.

The essence of a trading plan

The purpose of a trading plan is to assist you to manage the future as it unfolds in the market. Anything can happen in a market; your plan needs to account for that fact. It is the guide to your speculative activity.

Your plan allows you to anticipate the action required by the market as the price information becomes available moment by moment going forward.

A trading plan is not like the plan that is used to build a house for example. The house plan is a way to assemble and construct reality. Here you are certain that the plan will be implemented as directed. The trading plan is not like this. The market won’t do what you plan for it to do. It will do what it does regardless of your plan. When your plan agrees with the reality in the market, then you get paid. If it doesn’t agree with the market then you pay.

Does this mean that a trading plan isn’t useful? No indeed! It is essential to be planful. It does mean that your plan needs to be framed so that you stay in harmony with the market.

The function of your plan is to identify and execute high probability entries in the market, and then follow up. The plan needs to enable you to exit the position if and when the market turns against your position. But more importantly the plan needs to keep you in and even loading up on your position when it is correctly aligned with the direction of the price flow in the market.

In essence your plan allows you to anticipate and execute your next move to keep your position in harmony with the market. It is fluid and future focused, and strategic. An apt analogy here is playing chess. When one move is made you are preparing yourself for a range of possibilities to be implemented depending on the next move, and so on.

Some issues

The two biggest ‘killers’ for traders are impatience and hesitation. The planning process enables these to be overcome. Planfulness is the antidote to impulsiveness. Don’t enter the market because you feel like it or because you feel you are being left behind. You enter when you have planfully determined the probability for success is very high. Some traders use the language that the trade needs to be ‘set up’. The plan’s set up is really a ‘moment of truth’ for you. You have to wait patiently for it to materialise in the market.

A greater problem is related to procrastination when the set up or the plan’s ‘moment of truth’ has materialised. There is a temptation to wait to see if the plan works before an entry is executed. You can see the anomaly here. Hesitation implies that you need to know the future before you act. Hesitation acknowledges the fact that the trade can either win or lose. Of course a good plan accounts for this. If it loses, cut the position and go on to the next one. Hesitation means that if the trade is a winner the profit

potential has been reduced by the delay in its implementation. What hesitation means is that the plan is not trusted or respected.

The trading plan is a framework for managing uncertainty as the future unfolds. Another name for uncertainty is risk. Remember the higher the risk, the higher the return. A commonly held view is that the plan requires a check list of necessary conditions and confirmations before an action can be taken in the market. Unfortunately a trading plan that eliminates the risk will eliminate the profit as well. Optimally the plan should require execution after the first or early confirmation of the move. Waiting for all the ducks to line up is counterproductive.

Back testing

Essentially your trading plan is merely your best attempt to capture the reality of the market at this time. Your plan will be predicated upon your psychological biases and expectations. Remember you're just one player of millions engaging with the market. If the plan is indeed aligned with reality then you will prosper because of it.

Testing your plan on historical data is one way to test your plan's capacity to be profitable. Back testing a plan can determine its profit potential and provides feedback to improve its efficiency. It can raise your confidence in it.

Remember that the future is unknowable and your plan is framed as an extrapolation of information from the past. Your plan can not predict the future. Back testing can not guarantee the plan's success in the future.

The plan is not the problem

If you have a viable plan that positions you in high probability trades that cuts draw downs promptly and works the winners well, then it will create profit for you. A resourceful and responsive plan is usually not the problem. The problem is in psychological state of the operator. It takes time and practice to learn to execute a trading plan flawlessly.

If you have a good trading plan and it is not working then the problem is you.

The solution

I have worked with hundreds of traders across the spectrum of success and realised that automatic execution of trading plans is the key. Just imagine if we could eliminate all the psychological issues for the implementation of your plan. Just let it work in real time, engaging according to your plan with the market continuously 24 hours a trading day if required, as the market moves on.

Consequently I have worked with a small team of computer programmers so that we can optimise and convert your trading plan into a robot that trades the market faithfully and precisely as your plan dictates. The results in real time are remarkable. Taking the human operator out of the equation links the plan, its flawless execution and its profit generation.

This research shows the way forward for you. If you have a viable trading plan then you must implement it automatically, consistently and flawlessly with non attachment, timeliness and discipline. You need to apply your trading plan like a robot would.

Now that sounds like a plan.