Stop Losses Are For Sissies.

And other myths about forex trading.

By Rob Booker

Reading this ebook may cause you to lose money, make money, or, in rare cases where you are living on the North Asian continent, shave once per day, or are male or female, an arm may begin to grow out of your forehead and start slapping you on the cheeks. In this case, assume the lotus position and focus all of your energy into your spleen.

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The Almighty Stop Loss.

Stops matter more than almost anything else in trading. So few understand them. Some don't even use them at all – mental or otherwise.

The misunderstandings about stops contributes to more losses than just about anything else in trading. Think about your philosophy on stops. Do you have one? Can you articulate it?

I'm willing to bet that 99% of traders do not have written stop loss rules.

Right next to what's left of this beautiful apartment building in the Marina district is a stop sign. Right next to my first emptied and blown out account was a disregarded stop sign. So many of them. I ignored a lot of them.

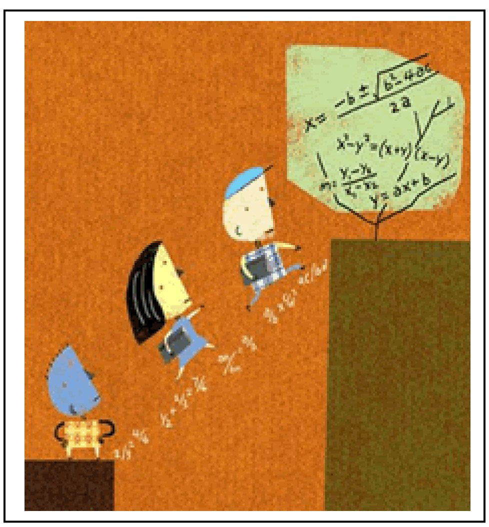
This ebook is about stops and using them correctly. It's about destroying some of the myths surrounding stop loss orders. It's about helping to make you a better trader.

I enjoy receiving your emails. If you have comments or stories about stop losses, or about your trading, let me know. I'd love to hear from you. I try to respond to every email I receive – it might take me a few days even with the number of emails I receive, but I still try to reply.

Myth 1: There is a Magic Ratio

I know that a zillion people are going to write me and criticize what I'm about to say. Let me say up front: if you read to the end of the ebook, we talk about what a smart ratio includes. I'm not against ratios per se. I'm just against "holy grail" ratios.

I think the illustration below captures the thought. People will tell you, on message boards and in courses and on the Web and in videos and in books that you have to have a "certain" ratio – your average win *has* to be greater than your average loss. Is this true? Is that really, really true?



No! It's a bunch of BS and it has caused more traders than I can list to go broke trying to get 50 pips for every 25 that they lose. Or 100 pips for every 30 that they lose, because someone was talking to them about having to have twice as many pips on their wins as they have on their losses.

You can't just think about your stops in relation to your gains. You can't cut off every trade just because it's reached a point at which it equals 50% of your average gain. That's ridiculous. While it might be true that you're doing really well if your average gain is bigger than your average loss, there is no – ever, ever ever – magic ratio. It simply does not exist. It never has, and it cannot be proven to have existed.

What if your average loss is 50 pips and your average gain is 50 pips, but your win% is 70%? Doesn't the reliability of your system have something to do with it? What if your system wins 68% of the time, and your average bet/trade size is 3% of your account value? Can you see what I'm getting at? If you only think of trading in terms of your avg loss vs. your avg. gain, you're not getting the entire picture.

I think that most people who talk about ratios are implicitly telling you this. They're assuming that your system is 50% profitable. I've even seen ratios where they "build in" your bet size and your win% -- those are better ratios by far. But don't become obsessed with finding a system that returns some magic ration of wins to losses. You don't have to find that magic ratio. It doesn't exist.

And here's the rule: **You need to backtest your system. You need to know its average win and loss. You need to set an optimal bet size. But there is no magic ratio.**

Myth 2: You Don't Need a Stop Loss

Think about it: what would your car look like if you took out the brakes? Hell, you don't need them! You can just take your foot off the gas when it's time to slow down, right!

People start to think that they should take out their stop loss because "Every time I lose, I realize that the trade came back later and everything worked out." Well, you know why that is? Because we were in the middle of a ranging market, where the price jumps up and down – and they get lucky. But what if the market stops ranging? What if it starts trending? In that case, if you don't have a stop, the trend ceases to be your friend. It becomes your worst enemy.

My first trading account was comprised of $2,000 that a friend gave me. He trusted me and he said, "Trade it. Lose it. It's trading money, not scared money. If you lose it, it's not a big deal." He thought that by saying that, I would be more relaxed. While there is some truth to that statement (scared money is rarely good trading money), it's also dangerous to say. Think about it. What do you think I did when I bought the USD/CHF and it started to fall? I thought, "The trade's going to come back to me. It's going to

start going up again." I also thought:

"This isn't scared money. I'm going to stay in the trade no matter what."

Of course, staying in the trade lost me my first account. You could already see that one coming, as soon as I mentioned it. If you hear someone say that you don't need a stop loss, then you're hearing a maniac. Do you need a stop loss *order*? A specific order in your trading platform? No. If you're worried about your broker "fishing for stops" then you can just have a mental stop loss order. This is a point at which you, as a disciplined trader, manually close the trade. This is harder to do than just putting the order in your trading platform or telling your broker over the phone – but it still works better than hiding from your losses as they grow and grow.

So here's the rule: You must at least, at the very least, have a Stop Loss order in your head (that you obey no matter what), or in your trading platform, or given to your broker over the phone.

Myth 3: My Broker Hunts for Stops

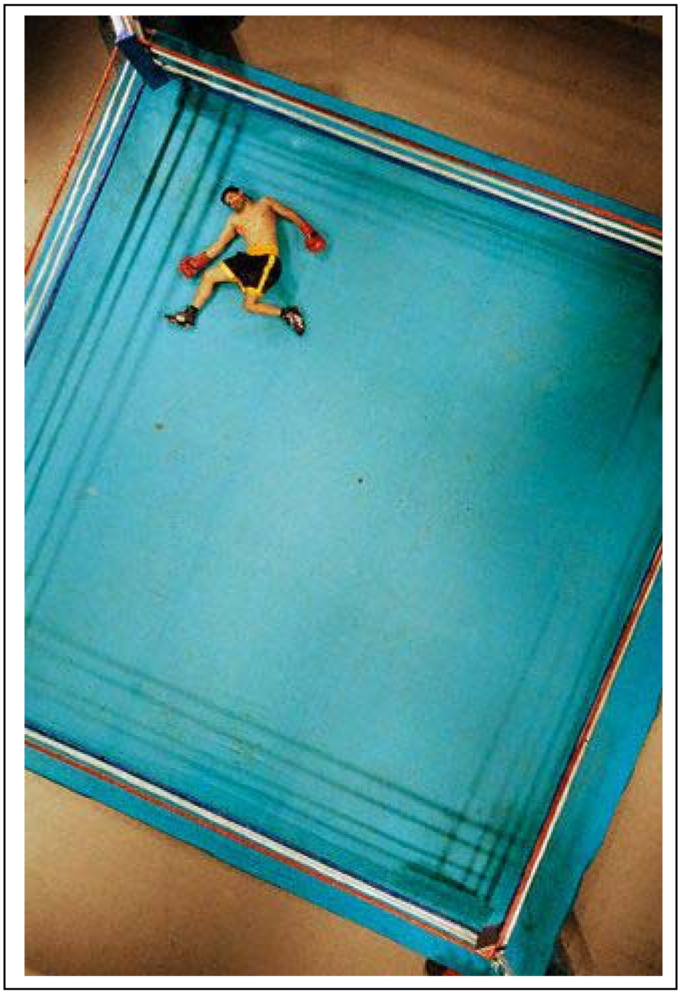
If your broker hunts for stops, then you need to change brokers. And please, don't fall for the "every spike means my broker is hunting for stops" mentality. Having your stop loss hit is part of trading. You have to build that into the plan. Orders are cleared out all the time by spikes. Do all the banks in the world conspire to hunt for stops together? Rarely. Does your broker? Perhaps. It's possible.

If you think that's what happened to you, then complain about it. Raise some hell. If it happens to you again, do the same. If your stop gets plucked a third time, though, then tough luck for you. You should have switched brokers.

I empathize with you if your stop keeps getting hit really close to where the trade turns around and runs in your favor. But you can't be complaining that "If my broker would stop hunting for stops, I would be a profitable trader." If you think that the world of currency brokers – all of them – are conspiring against you, then you're in the wrong business. You have to build *some* slippage (reasonable, not excessive) into your trading plan. You have to account for the fact that sometimes your stop is going to get hit unjustifiably and you're going to have to make a call. But don't become obsessed with a paranoid mentality about brokers hunting for stops. If every broker hunted for stops, then they would go out of business (and plenty of them do). The best solution here is to find a better broker and then stick with them, warts and all. No broker is perfect. Some are better than others, of course, but none are perfect.

Myth 4: No Matter What I Do, I Lose.

If you really believe this, here's what you need to do:



Take your wallet in your right hand, and then, with your left hand, grab some gasoline and a match. If this is too much to hold in your left hand, then use your foot to hold the match. Now pour the gasoline on your wallet. Now light it on fire.

You have to stop beating yourself up. I'm not sure if you think that self-affirmations (the power of positive thinking) is a load of crap or not. Actually, I don't really care. Well, I care about you *personally*, but I don't care if you think that positive thinking works or not. Because it does. The most successful traders in the world don't spend time thinking about what stupid people they are, about how prone to lose they are, about how awful they are, about how they don't deserve to be successful. They might not spend time in the lotus position thinking happy Zen thoughts, but they're certainly not bending over and thinking about how much it's going to hurt when the currency market gives them a swift kick in the backside.

Why do I even mention this? Because I've worked 1 on 1 with over 150 traders around the world, and I've seen that the pessimists – the negative thinkers – are the worst traders. They don't set stop losses. Then they do, but they set them in the wrong place. Then they don't again. It's a vicious cycle. If you don't want to think positive thoughts all the time, then please, at least don't start thinking negative ones.

Now, on the other hand, if you're willing to experiment a bit, and try something that works, look up Louise Hay's brilliant book, <u>You Can Heal Your Life</u>. Read it. Get more books like it. Start thinking more of yourself.

Truth 1: People Who Lose Deserve It.

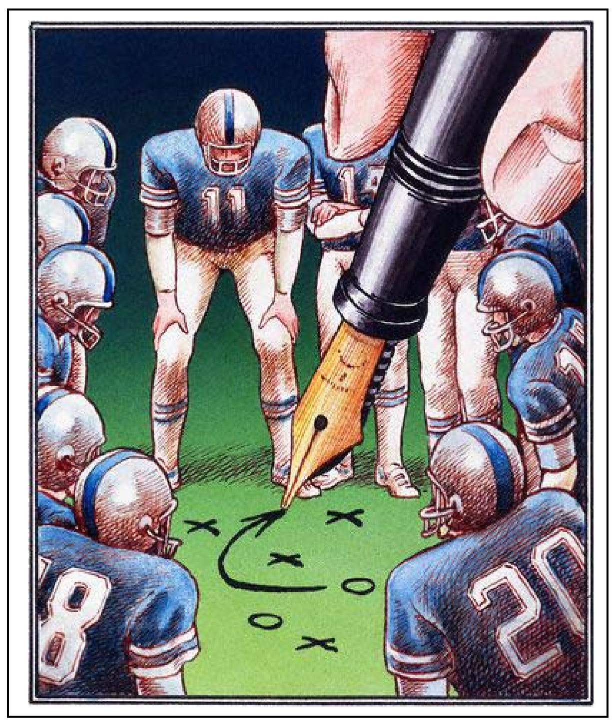
This is true. I wrote an entire ebook about this, which you can get for free on my Web site. But here's something I think I failed to include in the ebook: if you lose money in currency trading, you deserve to lose it. Currency trading has laws just like Physics, Math, Biology, or any other Science. When you break the law, there is a consequence. If you lost money, *that's* a consequence. Every consequence is preceded by some law.

I really mean this. It's true. You lost money when some natural law of trading is violated. Most of the time, it's because you don't have a trading system in place – no written rules (see more on that below). Sometimes, it's because you didn't set an appropriate stop.

When you start to take responsibility for your own losses, your trading improves.

Truth 2: The Best Stops Are Part of An Entire Trading Plan.

Can you imagine if McDonald's didn't provide rigid instructions on cooking their hamburgers? Do you know what would happen to quality control?



Uh, maybe that's a bad example. A lot of people think McDonald's is gross.

Okay, imagine it anyway: what if McDonald's entire business strategy was:

We'll look for good opportunities, and then we'll take them. No other rules, not about what constitutes a "good" opportunity. Not about what to put on the menu at individual restaurants.

Can you imagine how much *worse* McDonald's would be? No rules about how much to charge for food, no rules on whether

they should serve food at all (although this is actually a question I've had for some time).

Your trading is no different. If your trading plan can be summarized by the statement I'll look for good opportunities, and then I'll take them, then you're going to win some, lose more, win a few, lose more. You're not going to know why. You're just going to lose or win sporadically.

I have never met a successful trader – not once, anywhere – who had traded for more than 1 year successfully – that did not have a plan. Meaning, he/she had a plan that included:

1. **Rules for entries and exits**
2. **Rules for taking profit**
3. **Rules for taking losses**
4. **Rules for bet/trade size**
5. **A description of the overall system**

This is more important than I can communicate through words, so I am now sending ESP thoughts to your brain. Now do you feel how important I think it is?

Your best stop is just a product and a decision that is part of an overall plan. Too often, and I felt this as well when I first started, we think that we can just look for good trade opportunities and take them. This usually ends up just being trades taken when the market moves real quick on the 1 or 5 minute chart. Stops end up as the afterthought, rather than the forethought.

This is really super duper important: you have to think about, and decide upon, your stops *ahead of time*. Before you take the trade. You need to have a system in place that tells you what your rules are for stops. Of course the rules can be flexible! Of course you can change your implementation of the rules as necessary! But you've got to at least have a tried and tested system in place as a starting point.

Big Idea 1: Get a Plan.

Start today. If you don't have a plan, and don't know where to start, get a mentor that can help you get a plan. You can even buy some books on trading and start to work on your plan. It doesn't have to be fancy. It just has to be well-thought out.

Until you get a plan in place, you're going to feel anxious about your trades. In fact, even after you get a plan, you're going to feel anxious for a while, during the time that you learn to follow the plan and not go outside the boundaries of safe trades.

Here are some resources that you can read on the Web about putting a plan together, or at least they're interesting to read and they drive home some of the points from this ebook:

Ed Seykota's Money Management Page

I have some philosophical arguments on some of Ed's thinking, but I can't argue with his success. Read this Web page:

http://www.seykota.com/tribe/risk/index.htm

The Original Trading Turtles

Don't settle for substitutes. Get the original plan:

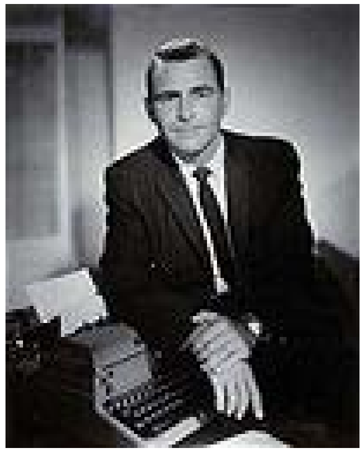
http://www.originalturtles.org/

StockCharts.com Trading Strategies

This is a nice list. You need to develop your own strategy, but this is a nice place to start:

http://stockcharts.com/education/TradingStrategies/index.html

That's about it. You can trade for a living. You don't have to be smarter than anyone else, or go to Wall Street, or have a huge trading account. You just need to be determined, disciplined, and have a plan.



About Rob

Boxer, Paratrooper, and general angry young man, Rob Booker was one of the radical new voices that made the 'Golden Age' of Television. Long before "Twilight Zone, The" (1959), he was known for writing such high quality scripts as 'Patterns' and 'Requiem for a Heavywieght'. Even "Twilight Zone, The" (1959) featured Forays into controversial grounds like racism, Cold War paranoia and the horrors of war. His maverick attitude eventually drove him from regular network television.

Oops. That's a biography for Rod Serling. Sorry. Next page.

About Me

I trade for a living. I think it's the best way to make a living in the whole wide world.

I also train others to trade for a living. I have worked with traders on nearly every continent, in nearly every country that we learn about in school. That's too many sentences that start with "I", so I'm going to start a new paragraph.

At my Web site (http://www.robbooker.com) there is a lot of free stuff for traders. Every day I try to add something new. If there's any way that I can help you, from training, to building a system, to just answering questions, let me know. I answer every email I receive. It might take me a few days, but I really try. As much of what I can offer, I offer for free. Some of my services cost money. I hope to hear from you.

Rob Booker