

Rolling It Forward

I have been teaching professional traders to become better traders since 1987, both at well known institutions [JPMorgan Chase, Goldman Sachs and Commodities Corporation] and various Exchanges . Over the past 23 years of teaching professional traders, it's become pretty easy to classify what trading practices will drain a trading account:

1. Not planning your trade before you enter it
2. Trading and not using 'hard' stops
3. Using too much leverage
4. Using stops that are too large [similar to number 3, above]
5. Being too anxious to find trades: Over Trading
6. Trading with Risk Reward Ratios too small for your winning percentage
7. Not sticking with your plan after the trade begins: Don't take profits because you are nervous. NEVER move your stop to a 'worse' level!

Traders are people and they tend to share the same human strengths and weaknesses. I like to say technical analysis is 80 percent science and 20 percent art [though that 20 percent is quite large!] and in this case, I'd say that keeping your thoughts and emotions under control when you trade is much more than half the battle. I like to plan my trades before I enter them and write the plans on paper with a pen [writing the plans on excel spread sheets on my computer do not evoke the same feelings in me]; this allows me to have the plan in front of me and I can 'follow along' or 'paint by the numbers' as the trade unfolds. If I get anxious or if I walk out of the trading room and come back in and need to refresh my mind, the plan is there in front me: I simply look at the plan, find my place, and go back to executing the original plan. Plans, if you stick with them, take many of the emotions out of your trading.

Last year, I had the good fortune to host a daily pre-market morning session, sponsored by the CME Group; I recently moved from Chicago to Arizona, so this year, the daily pre-market morning sessions became the Market Geometry Mid-Day Mini-Mentoring Sessions. Our goal at Market Geometry, and one we try to foster in each mid-day session, is to help each trader become more consistently profitable. For over an hour each day, we work hard on reading market structure, trying to identify the current frequency [or trend and speed of trend in any given market]. We always stress the importance of solid money management and good Risk Reward ratios. As each session unfolds, we never know where we are headed and where we are likely to end; the goal is to foster good trading practices and help members become more consistent in their trading.

One of the techniques we have been talking about recently has really struck a chord with some of our members and it has helped their trading immensely. I call it 'Rolling It Forward' and it's a technique that can help take the pressure of 'making money' out of your trading. If you are new to trading or you are not a consistently profitable trader, you constantly feel pressure to have a winning trade. This constant pressure clouds your judgment and often makes you take trades you would not have taken if this pressure weren't there; or this pressure causes you to change your trading plan, exiting trades early because you 'must' have a winner!

Though I hadn't started talking about 'Rolling It Forward' to the mid-day session members until a few months ago, the idea came about when I mentored about 350 Chicago Mercantile Exchange Members that were trying to learn to trade 'off floor', out of the pits, in 2005. Even though I had been a CME Member in the 1990's, I was surprised just how impulsively most of these professionals traded once they were 'off floor'. If the bars on the chart on their screens started to turn up, they'd often get long at the current price, with no thought about the where they would get out if the trade were profitable, no thought about where they'd get out if the trade turned against them. They bought or sold however many contracts they felt like trading at the time: sometimes 10, sometimes, 25, sometimes 5--there was no rhyme or reason. This meant they might make a wonderful trade using 5 contracts and follow it up with a losing trade using 25 contracts and then lose all they had just made and more! In short, most of them came off the floor and did whatever felt right--and it just wasn't working. And so they came to my CME Seminars, looking for guidance.

The idea of 'Rolling It Forward' is simple: If you use relatively constant position sizes and have a positive winning percentage, it's pretty easy to find yourself halfway through the month with enough profits in your account to nearly guarantee a winning month, assuming you keep trading the same style the rest of the month. But if you trade 'Helter Skelter', varying your position sizes and moving your stop loss orders when your emotions overcome your better judgment, you'll soon be looking for work as something other than a trader! There are many tips and tricks I developed to help off floor traders during that period, but this is one I had completely forgotten about until someone in one of the on-line Mid-Day Sessions asked me about position sizing [increasing the size of your positions as you accumulate more profits in your account].

I initially answered that the first and foremost goal was to become consistently profitable, and we still had too many people attending that weren't consistently profitable. I explained that 'consistently profitable' meant that if you looked at the new profits and losses of the past five or six months, one or two months should stick out--and those should be the losing months, not the winning months. Having profitable months had to be the 'norm' before you could even begin to think about increasing the size of your positions. And so I re-dedicated all we do at Market Geometry to making its members more consistently profitable. And that reminded me of the 'Rolling It Forward' exercise I had used with the CME Members and just how powerful a concept it can be. Let me walk you through it.

First, I went back and chose the results from a CME Professional member that was just beginning mentoring. These are the first five actual consecutive trades he brought to his first session for me to look at, in summary form [presenting them in a chart by chart form would not aid this discussion].

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U	
1																						
2		Starter Account																				
3																						
4		Beginning Account Size:									\$ 10,000											
5																						
6																						
7		All Expressed in S&P Points																				
8			Number of Contracts	Dollars Per Point	Outcome					Profit/Loss From Trade	Cumulative Profit/Loss	Cumulative Rate of return										
9		Trade 1																				
10			Initial Risk:	5	3	\$50.00	\$750.00														Comments:	
11			Initial Profit Target:	6	3	\$50.00	\$750.00															Initial stop too large; 1:1 Risk Reward very low unless your win/loss ratio is about 75 pct.
12			Realized Gain/Los:	5	3	\$50.00	\$750.00															
13			Net Percent Change:				7.50%			\$750.00	\$750.00	7.50%										
14		Trade 2																				
15			Initial Risk:	3	3	\$50.00	\$450.00															Comments:
16			Initial Profit Target:	8	3	\$50.00	\$1,200.00															Better Stop size better; exited trade early as it came back towards entry.
17			Realized Gain/Los:	2	3	\$50.00	\$300.00															
18			Net Percent Change:				3.00%			\$ 300.00	\$1,050.00	10.50%										
19		Trade 3																				
20			Initial Risk:	8	3	\$50.00	\$1,200.00															Comments:
21			Initial Profit Target:	13	3	\$50.00	\$1,950.00															Initial stop size extremely large; as price approached stop loss, changed it to a worse level and still stopped out. Stick with plan!
22			Realized Gain/Los:	-13	3	\$50.00	-\$1,950.00															
23			Net Percent Change:				-19.50%			\$ (1,950.00)	-\$900.00	-9.00%										
24		Trade 4																				
25			Initial Risk:	7	3	\$50.00	\$1,050.00															Comments:
26			Initial Profit Target:	16	3	\$50.00	\$2,400.00															Initial stop Loss too large. Moved stop loss to worse level again! Stick with plan!
27			Realized Gain/Los:	-10	3	\$50.00	-\$1,500.00															
28			Net Percent Change:				-15.00%			\$ (1,500.00)	-\$2,400.00	-24.00%										
29		Trade 5																				
30			Initial Risk:	5	3	\$50.00	\$750.00															Comments:
31			Initial Profit Target:	12	3	\$50.00	\$1,800.00															Initial stop better but too large. Moved Stop loss to worse level twice! No discipline! Plan better and stick with plan!
32			Realized Gain/Los:	-12	3	\$50.00	-\$1,800.00															
33			Net Percent Change:				-18.00%			\$ (1,800.00)	-\$4,200.00	-42.00%										
34																						

Looking at his composite spreadsheet, you can see his trade parameters as he planned them, the results and my comments.

He started out alright. My only advice to him was that in general, five S&P points was a little large for an initial stop because if he wanted to reach a 3:1 Risk Reward target, he'd have to take his profits fifteen S&P points past his entry--and fifteen points was at or around the entire day's average recent range, so he would have to catch most or all of the range on a normal day if he constantly used five point stops. I also noted that his original plan had included a 1:1 Risk Reward; in general, a trader would need to have a winning percentage of over 75 percent to trade with 1:1 risk reward ratios, after you factor in slippage and commissions.

I suggested he use slightly smaller initial stops and look for trades with Risk Rewards that were at 2:1 or higher. I personally do not take trades with initial stop losses larger than three S&P points and I never take a trade with a Risk Reward below 2:1--I am much more comfortable in the 3,4 or 5:1 area when intraday trading. I don't find these trades that difficult to find once you get used to looking for them and if I have to wait to find a trade that fits my acceptable profile, that doesn't bother me at all. I want to be consistently profitable and it costs me nothing to wait for an acceptable trade.

He had a good plan for his next trade: He used a smaller initial stop loss and the Risk Reward was greater than 2:1. The trade started out as a nice winner and looked like it was going to run straight to his profit target--it was already five S&P points in his favor! But when it began to turn back lower, he let his emotions get the better of him: He had that feeling that the market was going to continue to head lower and hit his stop loss. He didn't want to take a losing trade! This was the pressure of 'making money' talking to him and he threw his plan out of the window. Rather than risk having this trade become a loser, he panicked and took the two S&P Points still left in the trade [If you are curious, he would not have been stopped out and price would have reached his original profit target if he had stuck with his plan]. Once the trade was closed, he realized he had two winning trades for his first two trades. He was riding an emotional high: This 'off floor' trading wasn't hard!

The next day, he saw his third trade opportunity right after the S&P open, when the market gapped open lower. Most floor traders 'know' the market loves to fill open gaps, so that gave him his trade idea. He

already had two winning trades and was feeling good about his trading, so he decided he would go back to using 'looser' stops for this trade. The market had just opened and the economic numbers that had come out before the opening

[and caused the market to gap open lower] had left this market volatile, with fairly wide range bars. He didn't want to get stopped out and then have the market turn around and fill the gap!

This trade had nothing going for it: The initial stop was too large, the risk reward was poor, he was taking an entry right after the open that was fighting against the trend. And he made matters worse: When price got near his initial stop loss level, he looked at the screen and the size of the 'buy' orders shown by his platform. Then he watched price hesitate and turn just a bit higher. He was certain the buyers at this level would keep price from going lower, but price was so close to his stop, he cancelled his existing stop and moved it five S&P points lower. Remember, he just had two winning trades in a row and was running on an emotional high. He was certain price would never break through this level and hit his new stop loss order.

But price did break through the lows and quickly stopped him out for a rather large loss. On this single trade, a trade he was certain was a sure winner, he had lost all he had made on the prior two trades and quite a bit more. If you 'eye up' the first three trades, you should be able to see the usefulness of 'same size' maximum stop losses per contract, as well as what damage you can do to your account if you move your initial stop loss order to a worse level.

I haven't yet mentioned leverage. Though many brokers will let you trade three or four E Mini S&P contracts per \$10,000 Dollars, by doing so, you are exposing your account to extremely large percentage swings on each and every trade. Overtrading [trading too frequently] and using too much leverage will drain an account faster than anything else--and people that lose all the money in their accounts are generally guilty of both of these.

I understand not everyone has \$100,000 for their trading accounts or \$50,000 or even \$25,000. Many of you scraped about \$10,000 together [or a touch less] to begin trading. Think of this money as your Trading University funding. You need to practice, practice, practice--without losing all your capital. Using simulated trading is fine, up to a point, but eventually, you will have to trade using real money, because only then will you experience all the positive and negative emotions that you have to master before you can become a consistently successful trader.

If you are trading a \$10,000 account [or something close to that], if you choose to trade E Mini S&P futures, learn trading only one contract. That one contract will give you all the spills and chills and thrills you can handle, and then some. The goal is to survive the learning period, with as much of your capital intact as possible. No matter what instrument you decide to trade, use leverage carefully, use consistent sized smaller stops and don't take a trade just to take a trade: Have a trading plan and use it.

He continued to use a large initial stop [seven S&P points] for his fourth trade, because he saw what he thought was a great set up right after lunch: Price was trading in a range and when it broke out, he'd catch the move! This was going to be a sure 16 point winner and it would get him all the money he had lost on the last trade and a little more! He had two winners in a row; that last large loser was because of the opening gap, but it was afternoon now and he was sure he'd get his money back by the close.

Price broke out to the upside and he went long [just as he had in the morning]. He was sure now that they'd fill the gap left on the open--Price broke above the top of the range and he put his initial stop loss well below the bottom of the range.

Price went a little higher after he went long but then it broke back into the trading range; a few bars later, it headed towards the low of the trading range. Soon, he was looking at where his stop was placed and where price was trading and he realized he had only put his stop loss order one S&P point below the low of the range! He decided that was too close to the prior lows and they might 'wash and rinse' him and then take price back higher, but he wasn't going to let that happen! He moved his stop loss order to a worse level to give the trade more room. Now he was risking 10 S&P points to make 16 S&P points: The size of his stop was huge and his risk reward ratio was only 1.6:1.

They did wash and rinse those traders that had tried to go long at the bottom of the range; he breathed a sigh of relief when he wasn't stopped out and price climbed back into the range. But the relief didn't last long. Two bars later, price headed lower again and this time, ran into quite a few stop loss orders; the selling continued and he was quickly stopped out for his second losing trade.

Please take the time to notice that the size of his two losing trades are much larger than the size of his two winning trades. When you look at your trading statistics [and I hope you all keep trading statistics and review them regularly], this is a sign you are on the road to ruin.

When he eyed up what would be his fifth trade, he decided he had been risking too much on each trade. He decided to go back to the five S&P point stop he had used for his first trade; three S&P points seemed too small and he didn't want to lose seven more S&P points, so he settled on five S&P points. He had used five points on his largest winning trade--that one worked pretty good.

Price started to sell off on the opening and after watching it head lower for awhile, he decided the sell off was probably going to continue. He found a place on his chart where price had run into resistance yesterday afternoon and when price got to that area, he got short three S&P contracts.

Price congested underneath this area for five or six bars; to him, it felt like there was a giant order to sell just above the market! Other traders also had this feeling that there was a giant seller just above the market--and more and more short S&P positions were created right below this resistance area.

Price suddenly began to spike higher. He looked at his charts again and realized he had placed his stop loss order right at the bottom of that trading range from yesterday, so he moved it higher, now risking eight S&P points on the trade--but he was confident the bottom of the range from yesterday would stop the rise. And it did stop the rise for a few bars.

Then price began to creep higher, slowly edging into the trading range. As soon as he began to feel his stop loss order was in danger of being executed, his first thought was: I can't take another large losing trade! The last two losses had really cut into his trading account. He was certain price was just about to turn around and head lower--so he couldn't allow them to stop him out of his short position now! He moved his stop loss order higher [for the second time!] by four more S&P points.

The end of this trade came swift this time: Roughly two minutes after he cancelled his stop loss order and moved it higher by four points, price spiked much higher, taking him out of his position with a twelve point S&P loss.

In three trading days, he managed to have two winners and three losers. That's not a fatal win/loss ratio; in fact, if he had an actual risk reward ratio above 3:1, he would have net made money. But in his five

trades, he had made seven S&P points and lost 35 S&P points! You don't even have to do the math to know that that risk reward ratio was fatal.

In three trading days, he managed to take a \$10,000 trading account and lose \$4,200 of it. And the sad truth was he wasn't really trading a \$10,000 account; I proportionally down sized everything [his account and the positions sizes, profits and losses] to a \$10,000 account so most of you would better relate to the sizes of the wins and losses. He was actually trading with a multi-million Dollar account [so imagine how much money he actually lost].

'Where did I go wrong?', he asked me when we met at the end of the week. I started to list the mistakes--and he had made most of the mistakes I have on my 'Don't ever do this' list:

1. Don't use too much leverage. Once you become a consistently profitable trader, there are simple ways to slowly increase your position size without emptying your account.
2. Keep your stops relatively small. Stops are often your best friends. By using consistently sized maximum stops, you'll be around much longer to learn your trading skills.
3. NEVER trade without stops and NEVER move your stops to a 'worse' level. Once the trade begins, you have emotions tugging at you and you often make poor judgments; in my opinion, your first thoughts about a trade are usually the best because they came before this emotional tug of war.
4. A solid actual risk reward ratio pays for many sins. If your actual risk reward ratio is 3 or better, you can have three or four losses in a row and if you are using consistently sized smaller stops, you can still have a good month.
5. When you take a trade, don't think about 'getting the money back'. Take trades because they make sense. The market has no memory, so trying to take revenge on the market is a waste of emotional energy--and these 'revenge trades' seldom work.
6. If you find you have had several bad losses in a row, try taking a few days off to let your head clear and then evaluate what you were doing that led to the large losses. Make certain you learn something from your mistakes!
7. Set 'circuit breaker' levels in your trading account--perhaps at every ten percent. If you lose ten percent of your account, take some time off, then re-evaluate your trading plan. If you are trading multiple contracts, you must lower your number of contracts at one of these 'circuit breaker' levels. If you manage to make back the ten percent, you can always slowly increase your number of contracts.
8. Set rules for yourself and never violate them. If you violate a rule, impose a stiff penalty on yourself: a week off of trading? When you violate rules, it is a clear sign you are out of control.

What should a solid five trades look like? Here is a set of five consecutive trades I took in the 30 year Bond Futures. You can see the chart that spawned the last trade in last week's Moneyshow article: '*How to Develop Your GPS for Chart Reading*'.

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U
1																					
2		Starter Account																			
3		Beginning Account Size:																			
4											\$ 25,000										
5																					
6																					
7		All Expressed in Bond Ticks																			
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The first thing you should note is that I am using much less leverage than the trader in the first example. And I am using smaller consistent stops for each trade. I don't HAVE to use all five ticks, but I like to hide my stop order behind market structure and that generally takes all five points.

Now look at my planned or initial risk reward ratios: 6:1, 8:1, 4:1, 3:1 and 8:1. By looking for trades that realistically have initial risk reward ratios of better than 2:1, I am able to withstand two or three [and maybe four losses in a row] without doing much damage to my account. How do I know if the initial risk reward ratio is realistic? Here are the actual outcomes: 3:1, loss, loss, 3:1, 9:1. There is nothing I can do about the losses, but if my winning trades had actual risk reward ratios of 0.5, 1.2, 1.6 when I had been looking for 3:1 or 4:1 or 8:1, it would be time for me to re-evaluate how I was choosing my initial profit targets.

By using consistently sized smaller stops, the two consecutive losing trades didn't take my account into negative territory. And here's the key: In the first trade, I 'Rolled Forward' three stop losses. That means that when I took a profit of fifteen ticks in the bonds on that first trade, I had fifteen ticks in my account as padding against a string of losing trades. Since I was consistently using 5 tick stops, I could have lost five ticks on the next trade and only been back to break even--I still would not be feeling the pressure of 'needing to make money' to recover from large losses.

As I said last week, a picture is worth a thousand words. Let me show you what 'Rolling Forward Stops' look like.

	A	B	C	D	E	F	G	H	I	J	K	L	M	N
3		Rolling It Forward!		Bond Ticks		Maximum Stop Loss: 5 Ticks								
4														
6														
7		Trade 1	Initial Risk	5										
9			Initial Target	28										
11			Outcome of Trade	15										
13			Net to Date	15		3 Losses Rolled Forward		You can lose 3 trades and still be at break even now!						
15		Trade 2	Initial Risk	5										
17			Initial Target	40										
19			Outcome of Trade	-5										
21			Net to Date	10		2 Losses Rolled Forward		You can lose 2 trades and still be at break even now!						
23		Trade 3	Initial Risk	5										
25			Initial Target	22										
27			Outcome of Trade	-5										
29			Net to Date	5		1 Loss Rolled Forward		You can lose 1 trade and still be at break even now!						
31		Trade 4	Initial Risk	5										
33			Initial Target	15										
35			Outcome of Trade	15										
37			Net to Date	20		4 Losses Rolled Forward		You can lose 4 trades and still be at break even now!						
39		Trade 5	Initial Risk	5										
41			Initial Target	40										
43			Outcome of Trade	40										
45			Net to Date	66		13 Losses Rolled Forward		You can lose 13 trades and still be at break even now!						
46														

This spreadsheet says it all. You can see how many ticks I have added to my account after each winning trade and how many I lost from my account after each losing trade. The center column shows you how many losses I have 'Rolled Forward'. And finally, the last column shows you how many losses I have left in my account before I begin to draw down actual capital from my starting levels.

By using consistently sized smaller stops, even if I had started out with two losing trades, with a solid risk reward ratio of 2:1 or better, my third trade would have easily covered the losses from the first two losing trades. Don't dig big holes! Trust me, they are MUCH harder to fill up! Trade with consistent sized stops, use smaller leverage, only take trades that make sense and just keep Rolling Forward those stops.

The goal is to become a consistently profitable trader. And that means three or four winning months in a row--and the losing months should be barely negative, because you are controlling those losses!

Here's the secret to having a winning month: At the end of week three, if you have 13 losses rolled forward, it is extremely likely you will have a nice winning month. There is no pressure left for the rest of the month, so you can relax and trade free! And once that winning month closes, you have positive momentum to start the next month out with. Keep the same stops, the same risk reward ratios and the same realistic profit targets and do it again. Before you know it, you'll be on your third or fourth winning month. You'll be a consistently winning trader!

Just keep Rolling Them Forward!

I wish you good trading.

Timothy Morge

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