A Common Requirement

A traders coach is frequently asked for help in identifying potential trading systems with specific characteristics. This case study relates to one such type of request and identifies some of the lessons perhaps relevant for most traders whatever their trading style.

When some traders reach, what is for them, a good level of profitability, they often seem to look for methods of smoothing out their profits month to month, quarter to quarter. A common request of such traders goes something like "Please help me to find a second trading system or method to make profits when my existing trading system loses, so I can take a regular withdrawal out of my account."

It seems what they are after is a second, successful trading approach, with returns having a negative correlation with the profit profile of their existing system.

The Two Traders

Over the last 15 months several such requests were fielded and included at differing times, two particular traders - we will call them Jan and Antonio. Both are successful, each making at least 30% p.a. compound or more on their account value for several years. Both were dissatisfied with the level of drawdown they suffered in the process of a winning year.

The two traders, Jan and Antonio, have significantly differing preferred trading styles.

Jan

Jan trades one market, the S&P 500, using a volatility breakout approach. As might be expected for a successful trader, Jan has well-defined, objective criteria and follows her system with discipline. Her system and discipline provides large profits on a few trades, and relatively small losses on most trades.

Jan uses a time-frame that gives about 4 or 5 trades a month. It is rare for Jan to have a losing month, but monthly results have a large standard deviation of returns. A particularly bad series of losses (which Jan defines as more than 9 losing trades in a row) can take her months to recover from.

She wanted to trade an additional (overall profitable) trading system with a tendency to win when her current system lost. She was happy to lose some of her existing profits in profitable months as a price of having lower draw-downs.

Her trading style involves making single trades and closing out these single trades at a profit or loss before undertaking another trade.

Antonio

Antonio trades two main markets including the S&P 500. His trading approach is a market making style - he repeatedly sells into rises and repeatedly buys into falls. His concept is to combine two price-frames (as opposed to time-frames) - in practice this turns out to be a compound of the same simple trading system.

Antonio describes himself as being by character a trader of a trading method rather than a trading system. By this Antonio means he allows himself some discretion in initiating and closing trades. In practice this turns out to mean Antonio has clearly documented criteria within which his discretion can operate.

Antonio accepts that the market making style requires trading at a trade size such that he has the capacity to handle relatively large running losses for extended periods. While he is comfortable with this, he tried reducing his normal trade size so he could, in parallel, trade a third (very different) market using the same basic approach. He anticipated this would reduce his draw-downs as the two markets would tend to make big moves at different times. He reports overall profits on all markets, but not as much evening out of draw-downs as he anticipated and planned for. Like Jan, Antonio wanted help in finding another successful trading method to make profits when his system made losses and vice-versa.

His trading style involves having multiple open trades taken one unit at a time. Trades when closed are closed one unit at a time on a first in, first out basis.

Both Jan and Antonio had previously given authority for a structured outline of their trading system/methodology to be published to other clients. This uses the same list of description and criteria used in the TradersCALM Traders Procedure Manual for documenting trading systems and methodologies and had been verified as being an accurate and reasonably comprehensive description of her/his trading method by each trader.

This had the advantage that both Jan and Antonio is familiar with this manner of describing trading systems/methods.

The two traders requests for a second trading systems were separated in time by over three months. So each request had been treated individually, according to their needs and apparent capabilities at the time.

Of the various trading systems available and appropriate, it transpired that each had been provided with a description of the others trading system. So both had been given a second trading system that:

* had negative correlation of returns with their existing method as requested,
* used trading concepts alien to their normal mode of thinking.

Reaction, Surprise, Response

In their different ways, both Jan and Antonio had ‘adverse reactions’ to the system descriptions - a little like, perhaps, the way our bodies attempt to reject a foreign body such as in a heart transplant operation.

Both said, using different words, the equivalent of "Do not waste my time, give me another system."

Following reinforcement of the explanation of the history of success documented in the system description (percent per
The CALM Trader by Ric Ingram

annum return, draw-down pattern etcetera), both Jan and Antonio were persuaded to try paper trading the new (to them) system for a period of six weeks.

Of course they were unaware of the other traders experience until recently; and are still unaware of the actual identifiy of the other trader - their exchange of experiences has been via TradersCALM - and both want it kept that way.

Both were surprised that each others trading system could make money! And, while not still not fully convinced, agreed to continue paper trading for another two months.

They are both now in response mode, actually trading the new system alongside their favourite trading system, in order to smooth out their profits - and both are partially achieving their objectives.

For one, it is early days in terms of live trading experience.

What is noticeable is the change in openness and confidence being expressed by both Jan and Antonio. They both say they are happier in their trading. Both are asking more searching questions.

They are at differing stages in applying position sizing techniques to their new found discovery - but that is a different story. Any second part of the story will have to await their readiness and their approval for publication.

Lessons Learnt

There as many ways of trading as there are people. And from other experience we discover that some approaches have more inherent difficulties and some are more in tune with the way markets and people tend to operate. Yes, some approaches sit more happily than others based on a match with trader personality.

But a key lesson is if you are disciplined, you can successfully trade most systems, methods or approaches successfully - if you get past denial and into initial experience mode. Full integration into your very being as trader takes more experience - a trading system takes a while to become yours. What seems to happen to many who trade one system is that the trading system starts to own them rather than the trader owning the system.

Experience is still a powerful route to behaviour change. There is no limit to the opportunities to learn provided by getting past denial and inertia and gaining experience.

A Tale of Two Traders - A Follow-up

The Story Continues

This story is a continuation of 'A Tale of Two Traders' and assumes you have read their case study. Both Jan and Antonio had been surprised the others trading system could make money!

They had gone from initial rejection to agreeing to paper trade, to actually trading, in small units, the new (for them) trading system. Both discovered a new source of profits. Both are beginning to ask more searching questions and express more confidence in their trading. It is as if both have begun to understand more clearly, by way of contrast with their original trading approach, how their original trading approach could be enhanced. But what have they done?

Jan has probably moved forward the farthest, quickly progressing from paper trading to small unit sized trading of the new (to her) system. Then, using risk of ruin calculations, she twice optimised the relative trade size weighting for her volatility breakout system and a relative trade size weighting for the new (to her) market making system. She has adjusted to a multiple entry concept very quickly and has achieved her objective of more even monthly profits. She reports that her expectations of an even profit profile have been exceeded. Her risk of ruin has gone down six-fold while her average monthly profits are 15% higher. Although Jan does not feel any different, her questions demonstrate a much-improved level of confidence. Perhaps this is reflected in her determination to extract the maximum leverage from her new experiences and her feeling of confidence will show itself when she feels this process has run its course.

Antonio has had more difficulties in applying the new (to him) trading system. Like Jan, he reacted emotionally to the trading system description. Like Jan he has paper traded the new (for him) system, traded using small unit sizes and is making money with the new system. But it wasn't until he decided to concentrate on the S & P 500 market that he has begun to get what he was searching for - more even profits. With some encouragement from TradersCALM, Antonio has used his risk of ruin calculations to more appropriately select relative trade sizes for the two trading systems. He reports more even trading profits (this time in terms of a lower maximum drawdown rather than more even monthly profits) and a tentative halving of risk of ruin with a provisional 25% increase in overall profits. Once again improvements in confidence are expressed in the nature of the questions Antonio is asking. This time Antonio can feel the improved confidence and plans to rest on his success while planning ways to further exploit his experiences.

Lessons Learnt

These are a little different from last time. We learn best from experience. Everyone is different and needs different encouragement.

Emotional reactions can be just that - reactions not responses. We can equally benefit from going with our gut-feelings as we can from getting past our initial emotional reactions. To distinguish between whether it is our higher-self speaking to us, or just an emotional reaction, we can ask ourselves the simple question - 'Am I emotional at this time?'

Full integration of a trading system into your very being as trader takes more experience - a trading system takes a while to become yours.

What seems to happen to many who trade one system is that the trading system starts to own them rather than the trader owning the system.

Experience is still a powerful route to behaviour change. There is no limit to the opportunities to learn provided by getting past denial and inertia and gaining experience.

Go for it!