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DailyFX Research

www.dailyfx.com
www.fxcm.com
sales@fxcm.com
1.212.897.7600
1.888-50-FOREX

Top 10 Trading Lessons from 2007

By DailyFX Research Team
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Happy Holidays! At DailyFX, we always say that we are **Traders First and Analysts Second**. Each and every one of the Analysts on the DailyFX Team actively trade in the markets and we wanted to take this opportunity to share with you, real trading lessons that we have learned this past year.

Lesson # 1: Don't Ignore the Warning Signs

According to Wikipedia, a tsunami is a series of waves created when a body of water, such as an ocean, is rapidly displaced. A tsunami cannot be prevented or precisely predicted, but there are some warning signs of an impending tsunami. In instances where the leading edge of the tsunami wave is its trough, the sea will recede from the coast half of the wave's period before the wave's arrival. If the slope of the coastal seabed is shallow, this recession can exceed many hundreds of meters. People unaware of the danger may remain at the shore due to curiosity, or for collecting fish from the exposed seabed. This was exactly what happened to me. Even though, I felt the initial subprime earthquake (I went short U.S. interest rates in anticipation of rate cuts), I failed to run for cover when the first waves of destruction started hitting the U.S. economy (Merrill Lynch, Bear Stearns, UBS all started reveling colossal losses tied to subprime problems). I assumed that stocks would rally in the months ahead because of the rate cuts and went long USDJPY. Next time I see that the sea is receding from the coast I will assume that a tsunami is coming. I will run for cover and come back to the market when the volatility drops to more normal levels. – *Antonio Sousa*

Lesson # 2: Don't Be Right in Your Analysis, but Miss the Trade

I have made some great calls in 2007 including the EURUSD rising from 1.34 to 1.48 and USDCAD's fall below parity and its eventual bounce back above it. Even though I was right in my analysis, I didn't take the trade. By the time my strategy flashed buy and sell signals on these currency pairs, the stops were much larger than what I am normally comfortable with, which is 100 pips or less. Yet the eventual rewards were far greater than the 150 to 200 point risk that was needed. As a great trader once told me, "one of the worst sins in trading is to be right in your analysis, have it move dramatically in your favor, and not be on board for the ride." Next time, I'll adjust my position size so that I can still risk the same dollar amount on the trade but take a wider stop because oftentimes trades as great as these only happen a few times a year. – *Kathy Lien*

Lesson # 3: Trust Your Methodology

The most important lesson that I have learned (and I feel like I have learned it many times) is to TRUST YOUR METHOD. You must have a methodology by which you go about your trading *business* and you must trust it; otherwise you are not operating in a businesslike manner, but rather a chaotic manner...and where is there is chaos, there is nothing. This is a general lesson but I'll give an example.

My method has always been to identify market extremes. I rely on a combination of things; sentiment indicators and wave counts are the two most important. It was July and COT was telling me that the JPY was very oversold and GBP was very overbought. My wave count (with Fibonacci extensions) indicated that the top for GBPJPY should be near 250.00. I had actually put in orders to sell GBPJPY at 250.50 and every 50 pips up until 252 with a stop above 253. As GBPJPY approached 250, I got nervous, cancelled everything and actually went long! I remember all the talk about how the break through 250 would lead to 255...blah blah. Not knowing what I do now, I actually chased the crowd. As it happened, the GBPJPY top was at 251.10 and within 1 month the pair fell to 219.30. There is no way I would have held onto the position until the bottom but I would have made out nicely if I stuck to my initial strategy to short. Instead, I got a margin call because I was long, which was the opposite of everything that my analysis told me. I was literally sick from this. Whenever I think about going against my plan, I remember that incident.

If I lose money because my plan got me into the wrong trade, then I am fine with it, but if I lose money because I went against my methodology, then I do not have the discipline to be trading in the first place. – *Jamie Saettele*

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Lesson # 4: Take the Time to Find the Best Trade, Don't Rush Into It

Not keeping a diary was huge mistake that I made this year. Keeping a diary forces you to think through your idea because you have to write it down. By thinking about the trade instead of rushing it, you will be more critical and more selective in choosing the best trades to take. Additionally a written record provides you with an opportunity to review your thought process so that you can replicate the successful ideas and modify the unsuccessful ones. For example a while back I liked CAD to the short side but choose AUDCAD instead of USDCAD because I was rushing the trade idea and forgot to check the calendar for event risk which was negative to the Aussie. Now I always make sure to check the calendar as part of my process of keeping a diary of trades. *– Boris Schlossberg*

Lesson # 5: Don't Ignore Signals from Other Successful Trading Strategies

If you are in an open trade according to a specific strategy, don't completely ignore signals you see from another successful trading strategy. A specific example comes to mind where I went long the USDCHF according to a dependable signal I got from the Commitment of Traders Report. I generally think that such sentiment-linked data provides excellent trading opportunities, and I acted on a fairly clear signal to buy. The trade initially went in my direction, but I began seeing conflicting signals from another sentiment-based signal--the Speculative Sentiment Index (SSI). I held on to the trade thinking that it was best to close it only if the COT-based bias changed, but I subsequently saw the position go against me rather dramatically on a clear sell signal from the SSI. In retrospect it was wishful thinking to believe that the currency pair could continue higher despite fairly clear signal that it may reverse from other dependable measures. *– David Rodriguez*

Lesson #6: Always be Aware of the Bigger Picture

Often, through 2007, I would make trades based on 60 minute and 240-minute time frame charts. While this was a good time frame to monitor technical formations that are triggered and take profit as one session ends and the next begins, as well as watching for event-driven breakouts; isolating myself to this granularity would sometimes lead me to miss the larger technicals that can't be seen with so little historical data. For example, a 61.8% Fibonacci retracement on a wave that spans 8 months is clearly not visible on the 240-minute chart that only calls up 40-days worth of data. If that is just 20 points above your position and a short-term setup tells you its time to get long, you have a much higher chance of being stopped out if you ignored the resistance point. *– John Kicklighter*

Lesson #7: Know When to Cut Your Losses

Don't be stubborn - Conditions change all the time, whether they are fundamental or technical in nature. It's easy to stay too focused on one particular thing, such as a support/resistance level, that you are 'confident' will play out your way. When it doesn't, quit. Know when to cut your losses and don't sit and try to wait for it to do what you want it to. *– Terri*

Our Last 3 Trading Lessons are Kernels of Wisdom from Jamie Saettele and Antonio Sousa:

Lesson #8: Markets can be Wrong for a Very Long Time
Just take the example of how rate cut expectations went from pricing nothing at in July to 4 rate cuts before year end as the credit market conditions started to reveal how bad the housing market was doing. *– Antonio Sousa*

Lesson # 9: Markets are Deceptive. What Seems Obvious is Usually Wrong
The perfect example is the obvious forecasts for $100 oil and the EURUSD hitting 1.50 by the end of the year. *– Jamie Saettele*

Lesson #10: Know When to Step Aside
This lesson reminds me of a quote from Reminiscences of a Stock Operator. It is advice that an old broker gives to Larry, he says..."If I am walking along a railroad track and I see a train coming towards me at sixty miles an hour, do I keep walking on the ties? Friend, I sidestep. And I do not even pat myself on the back for being so wise and prudent." *- Jamie Saettele*

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