BASIC TRAINING FOR FUTURES TRADERS:

14 Recommendations from a Top Futures Broker

Stuart A. Vosk

Disclaimer: Trading in futures and options is not suitable for all investors as the risk of loss is substantial. Where this material mentions entering stop loss orders, one must be aware that the use of stop loss or contingent orders may not protect profits or limit losses to the amount intended. Certain market conditions make it difficult or impossible to execute such orders.

Center for Futures Education, Inc.
P.O. Box 309
Grove City, PA 16127
Tel.: (724) 458-5860
FAX: (724) 458-5962
e-mail: info@thectr.com
http://www.thectr.com

Over the last twenty-five years as a futures broker and trader, I have learned a few rules which seem to reaffirm their importance time and again. Some of them may seem fairly logical, but because the futures market tends to stir one's emotions, sometimes the logical thinking goes out the window. Some of the other rules may seem contrary to reason, but they have saved me and made me a lot of money over the years. These rules are listed in no particular order of importance.

1. Learn how to trade and make your own trades. Take your time and study the art and science of futures trading. There are many books available. Don't feel that if you don't get into the market right away you will miss something. In the futures market, there is always another good trade right around the corner. Do not turn over your account to someone else to trade for you. If this person were any good, he wouldn't need the commissions from your account, he could be making all the money he needed by trading his own account. If you get a list of commodity trading advisors, you will see that, on balance, they underperform equity mutual funds (which don't have the same risk as futures). Don't listen to tips from other people, especially your broker. Brokers derive their income from commissions, and it is a benefit to them if you trade. I am not saying don't use a broker, I am just saying that if you do your own homework, you will know as much about the markets as he does. Also, if you make your own trades with no help from a broker, you can get lower commissions. Also, make sure that your broker is a futures broker, not a stock broker who does futures. In addition, make sure the broker is available all the time or has a backup who is.

2. Look for trades that have a high profit potential and a low risk, and that also have a high probability of winning. The old phrase about cutting your losses short and letting your profits run is true. Because you will lose on many of the trades you make, the winners have to be much larger than the losers. How do you increase the probability of winning trades? Be very selective in your trading. If you find a market that is trading below the cost of production without demand waning, there is a very good probability that eventually this market will go higher. If the market is at all-time highs without a decrease in supply or an increase in demand, chances are that eventually it will go lower. Making these kinds of trades will increase your probability of success.

3. Plan your trade, and then trade your plan. View each trade as if you were starting a new business venture (in fact, you are). If you want to make a particular trade based on the homework that you have done, and you have set up the parameters (how much you are willing to risk, and what you think your profit potential is), there is usually no reason to vary from that plan. Don't get emotional staying in the trade and letting the losses become too large because you couldn't stand to take a small loss. Don't get out of the trade too soon because you have a small profit and it is the first one you have had in some time. Use your plan to discipline you in your trading.

4. Don't ever day trade. In all my years as a commodity broker, I have never seen anyone consistently make money by day trading. The fills you receive will never be what you think they should be, and the commission will eat up any profits you might have. Also, because most day trades only make small amounts of money, you will have to win a very large percentage of your trades to net any profits at the end of a year. Again, of the hundreds and hundreds of people I have known over the years, not one has ever made and kept any profits from day trading. When I first started in the business in 1973, I was day trading silver and had won on about fifteen or twenty trades in a row. One day, I was short silver when the news of the Arab Israeli war broke, and silver went limit up, wiping out all the profits I had made on previous trades. It took a few more years of trying, but I found that unless you are a floor trader, you cannot win by day trading. I had a client a few years ago who purchased a day trading system for S&P futures. He even went to a class to learn how to use it properly. He traded with me for a while, lost some money, and then went to a different broker who told him he would get the kind of fills necessary to day trade, as well as very low commissions. Last I heard, this trader had wiped his trading capital out.

5. Follow up all winning trades with stop profit orders. Most people have heard of stop loss orders. That means placing an order in the market after you have initiated a trade to protect yourself from losing too much money. What should you do after the trade has gone your way, and you are profitable? Most people take their profits (normally too soon) or watch as the markets reverse and the profits turn into losses. Why not have an order in the market to protect the profit? That way, if the market continues in your direction, you continue to make money. In a normal market, when the market reverses, you should be stopped out, and should still have some of your profits. In a highly volatile market, this may not be the case. I had a client in 1987 who had a $750,000 profit in a trade. When I spoke with him in the morning and suggested to put in a stop to protect his profits, he said "Nah, let's shoot for a million." The markets crashed about an hour after our conversation and by the end of the day his account was worth $50,000. It's O.K. to stay in the market for a larger profit, but protect yourself against market reversals with stops.

6. Most traders buy a futures contract because the concept of going short is foreign to them. **You can make just as much money from the short side as you can from the long side, and normally much faster.** Nevertheless, there are some extra things that you must be aware of when trading from the short side. First, higher priced markets (those that you will probably be considering for a short trade) are normally more volatile that lower priced markets; therefore, you may have to place your stop loss order slightly farther from the market price. Also, there is no limit to how high a market can go, but there is a limit to how low it can go; therefore, going short tends to be a little riskier than going long, but again, you can make profits faster, so that is the trade off.

7. Have enough money in your account, and consider it lost before you even start to trade. Put in as much as you can afford or wish to risk; no more, no less. If you lose it, quit trading. Do not put in any more money in an effort to get back what you lost because you will only lose that money also. If you start to make money, withdraw the amount over your initial deposit, and don't put it back in. In other words, if you were willing to risk $25,000, and your account grew to $50,000, do not risk the $50,000. Take $25,000 out of your account. If you then lose the $25,000 that's still in the account, quit trading. How much is the right amount? Only you know how much you can afford to lose. If you don't have at least $10,000, I wouldn't even consider trading futures, but $25,000 is better. Anything less doesn't give you enough leaway if you happen to start out on a losing streak.

8. Once you have decided how much money you are willing to risk, do not put it all into one trade. A good rule of thumb is not to risk more that 5% of your trading capital on any one trade. This does not mean that the amount of margin on the trade is 5% of your trading capital. It may be much more than that, just don't lose more than 5% on any one trade. In this way, you will have many opportunities to try to profit from the markets. The margin on an S&P futures contract is $20,000. If you had $40,000 in your account you wouldn't risk more than $2,000 (5% of $40,000) on the trade.

9. Markets aren't always a buy or a sell. Sometimes they are a nothing. **Therefore, don't always think that you must be in the market.** I have had a number of clients over the years who would call every morning to see what they could trade, not necessarily what they should trade. They just loved the action and felt they were going to miss some big money if they didn't trade. They were half right. They missed (lost) some big money. All they ever got was the action, no profits.

If you have a workable system that makes you money, keep using it until it proves it doesn't work any more. Many traders continually refine their system until it stops working. Then, rather than going back to what they originally had, they venture into different areas of analysis. I believe, if it ain't broke, don't fix it. I recently had a client whom I had shown a particular trading system I was working on. I told him it was a rather unusual system, but if he stuck with it, it might make him some money. After four or five winning trades, he decided to "improve" the system. After then losing four or five trades in a row, he quit trading. He didn't go back to the original system that had made him some money.

10. Try and catch a move as close to the bottom (if buying) or top (if selling), but don't bottom or top pick. This may sound like a contradiction, but it really isn't. When you think a market is approaching its extreme, start paying very close attention to it, and wait for the market to tell you it is reversing. In other words, don't buy a market that keeps going lower, or sell a market that keeps going higher. If you must try to pick the bottom or top, do so using options.

11. Every once in a while, get out of the markets and take a breather. This applies whether you are winning or losing. Trading generates more trading which generates more trading. If you don't keep your perspective and view each and every trade as a new business venture, you will start to trade just for the sake of trading.

12. Use a charting service or your personal computer to do as much of the work for you as possible. There is some very good software on the market that facilitates futures trading. If you don't have or don't want to get involved with computers, you should subscribe to a charting service. Doing it all by hand is possible, but will take much too much time and effort.

13. If at all possible, do not open a joint account with a friend. Not only will you lose money, but you will probably also lose a friend. Quite often I have clients who can't quite afford to open an account on their own, so they have a friend go into it with them. Soon they start blaming each other for the bad trades. You are better off waiting until you have enough money of your own to trade. Until you have the right amount of risk capital, paper trade to see if the trading plan you have developed is workable and profitable.

14. Choose your brokerage house carefully. Make sure they are futures oriented. Many brokerage houses do futures, but only because they have to as a convenience to their stock clients, not because they are committed to the futures business. Also, make sure you can get reasonable research from them, along with good fills and low commission rates. If a mistake occurs in your account, don't let your broker talk you out of contacting his manager. If you don't make note of it to management immediately, your chances of getting it rectified later are not as good. Whether to use a full-service brokerage house or a discount brokerage house is up to you. The differences between them are becoming much less noticeable.

Hypothetical performance results have many inherent limitations. No representation is being made that any person will or is likely to achieve similar profits or losses to those depicted in this pamphlet. There are great differences between hypothetical performance results and actual results achieved by any particular trading system. Hypothetical performance results have the benefit of hindsight. Hypothetical performance results do not take into account the psychological impact of financial loss. Past performance is not indicative of future results. The risk of substantial loss exists in futures trading.

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