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Top Trading Lessons of 2015

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A good trader never stops learning, and every mistake is another potential learning experience. Here are some of the top lessons our analysts learned, absorbed or suffered from our personal trading in 2015.

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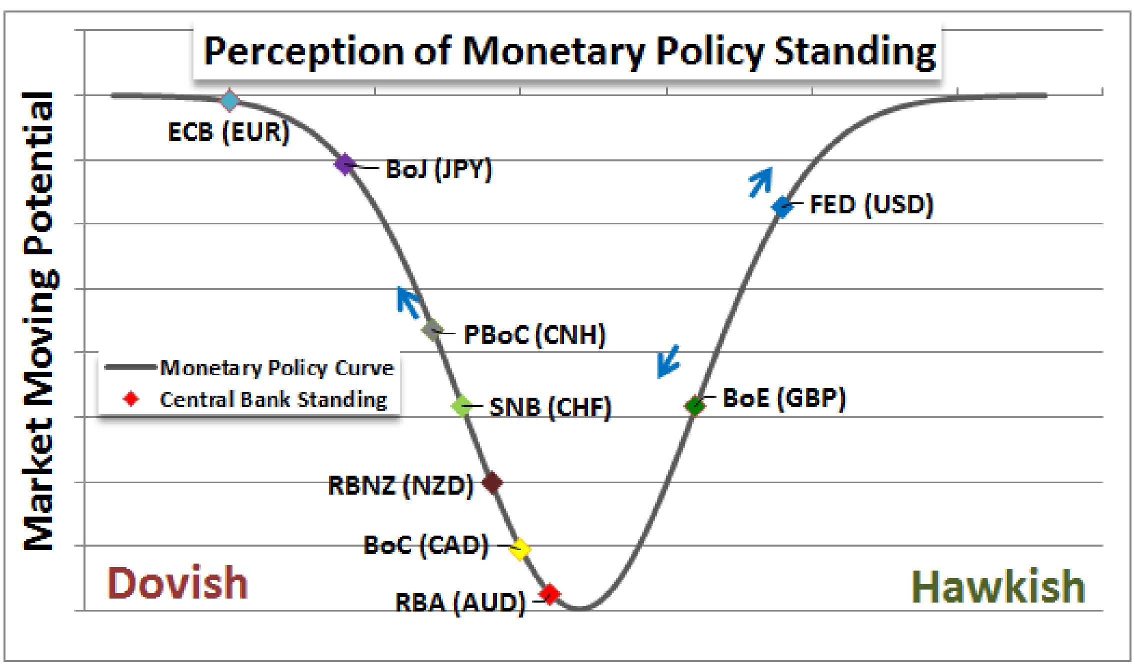
FOREX MARKET NEWS AND ANALYSIS

John Kicklighter, Chief Strategist

Key Fundamental Themes Can and Do Change

Fundamental analysis plays a crucial role in my trading. I may come across the most pristine technical setup I have ever laid eyes on and still would not take the trade if it directly conflicted with my fundamental evaluation. For me, this essential appraisal of the market starts with a big picture rooted in a top theme (such as general risk appetite or divergent monetary policy bearings). Without that comprehensive and persistent current feeding a trend, a move would be piecemeal and more likely to stall or reverse. That said, these overriding market motivators, can and do change with circumstance. I grew complacent to these shifting tides a few times this past year – particularly with the 'relative monetary policy' theme.

The first of these lessons was learned early in the year with the Swiss National Bank's (SNB) failure to keep the floor underneath the EUR/CHF exchange rate. I took their vow to keep the 1.20 exchange rate in place – labeled a 'pillar' only a few days before its being abandoned – as inviolable. I did not in turn give enough credence to data showing the astronomical cost the policy effort was tallying for the effort. Even central banks have limits. Market evaluations can also shift, as I didn't initially appreciate with the Euro's position. After the European Central Bank (ECB) cut deposit rates to negative and embarked on a massive QE program, its currency took on the more traditional characteristics of a 'funding currency'. I had thought the carry trade sidelined as rates were very low globally, but when the Euro surged alongside the August plunge in 'risky' positions, it was clear it had taken on a different bearing.



Graph Prepared by John Kicklighter based on Qualitative Evaluations

David Rodriguez, Quantitative Strategist

Never Judge a System on a Long Streak – Winning or Losing

As 2015 comes to a close I'm happy to report that I successfully learned from my biggest mistake last year—less is often more, and trading is no exception. I played to my strengths and did virtually all of my trading via low-intervention algorithmic trading systems. But trading is an iterative process, and switching my methods exposed another issue. I kept my emotions away from single trade decisions, but emotions can (and did) get in the way of making sound strategy selection decisions all the same.

I've devised a number of techniques for selecting trading strategies at any given time, but at the end of the day it's clear I'm not immune from a beautiful equity curve. This is exactly what happened with one of our volatility-friendly trading systems headed into the European Central Bank interest rate decision on December 3.

There were a number of reasons to believe that the system would continue to do well in the EUR/USD, but I knew the event risk was substantial and I would typically reduce leverage ahead of big news events. My over-reliance on the equity curve made for some fairly significant losses. I kept the system active at normal trade size, and a substantial EUR/USD reversal erased roughly 4 months of trading gains for this strategy in the EUR/USD.

It was easy to see how the allure of the beautiful equity curve clouded my judgment, and this ended as a costly lesson in trading discipline. Of course, if I take the implications to heart it should pay for itself in the future.

Jamie Saettele, CMT, Senior Technical Strategist

Look Before you Jump, not When You Jump

Last year in this space, I spoke of the 3 P's; Process, Preparation, and Patience. In summary, the lesson was 'have a process that generates signals, prepare to make decisions based on the process, and exercise patience when it's not working." This year's lesson, 'have the courage of your convictions', builds on that theme (convictions may as well be the 3 P's). This can be said another way; 'look before you jump but not when you jump'. Dickson Watts wrote these words in 'Speculation as a Fine Art'. The publication is the size of a pamphlet and it's one of my favorite trading books. Anyway, the jumping is the execution and there is a lot of room for improvement on my end in that area. Here's how it relates to my 2015 experience.

The first quarter was great. Executing the plan isn't a problem during a hot streak but becomes a struggle (for me anyway) during a drawdown. So, great first quarter but April was tough. I had been tracking NZD/USD for a big short (was a 'trade of the year') and the acceleration period of the move was launched by a wedge that completed in early May (see here). I was short at the time but not short enough given the circumstances. I never added to the trade and got out way too early as well. Had I possessed the 'courage of my conviction' and NOT 'looked when jumping' (remember….look before...the analysis was done and the trade was there), 2015 could have been a great year rather than simply a good year.

Jeremy Wagner, Head Trading Instructor

A Pinch of Patience

Overtrading is a common obstacle for many traders. The 24 hour nature of FX means opportunities are abundant and it is easy to get excited about the trades available. However, not all trades are created equal. Some trades offer better risk to reward ratios than others. Some trades have a multitude of patterns pointing in the same direction and some do not. Overtrading is feeling like we need to jump on all opportunities now (including the poor risk to reward ratio trades) because we fear they'll be gone tomorrow. In essence, overtrading is a result of sensing scarcity.

What a minute! We know there will be more opportunities tomorrow. We know FX trades 24 hours a day. Tomorrow will bring the same dance perhaps with a different song playing or a different DJ directing the music. Why do we act like opportunities are scarce?

Several reasons, though, with empirical observation being that we never know the results of the trade before it happens so we feel like throwing spaghetti against the wall. That poor risk to reward ratio trade might 'stick' and add value to our P/L.

This year, the collateral benefits of automated trading became apparent since the 'bot' is constantly looking for trades and doesn't get tired. Though I have a mix of auto strategies and discretionary trades running, I don't mix the markets running on auto with those running in discretionary.

There were several days this past summer where I was completely unplugged from the market due to some holiday time. During the holiday, I let the automated strategies continue to run. Later on, it finally clicked for me the bigger benefit from automation…the mental capacity to be patient.

It reminds me of the benchwarmer in basketball who has a great attitude. His role on the team isn't to score a bazillion points. He's the first one to greet you on upcoming time outs. He gives you a high five after you nailed the 3 pointer. He offers words of encouragement after you turn the ball over. In essence, he assists you to become the best you can be so the team can win.

Automation is like that player. I don't need automation to add a bazillion dollars to my P/L (though I would take it if it happened). Help me become better with my discretionary trades! Simply free my mind of market noise. With my mental alertness fresh, I am more available to focus on finding and trading the higher probability opportunities. That is a larger benefit than the P/L contribution in my opinion.

The auto trades gave my trading recipe the pinch of patience that helped me filter out those discretionary spaghetti noodles less likely to stick.

Kristian Kerr, Senior Currency Strategist

Stop Staring at P&L

I am a dicretionary trader. It just fits my personality and how I view the markets and the world. Admittedly one of the hardest aspects of trading discretionary is the emotional toll it can have on you. Whether it be P&L swings or a series of bad trade ideas it is often hard not to take it personally which can easily creep into decision making. Over the years I have learned a few tricks here and there that have helped me mitigate a lot of this emotional stress and save loads of mental capital.

Perhaps the most useful was to hide my P&L numbers from view. Early on in my trading career I was fixated on the real-time P&L numbers on my blotter until one day I realized I was making more decisions based on P&L than what was going on in my charts. I was trading emotionally and this is usually a bad place to be. The more I tried not to look the greater the pull to see how I was doing until one day I just closed the window out. A funny thing happened next. I stopped viewing the market in terms of things I could buy or other things and started trading rationally what was in front of me on my screens. Not surprisingly my results almost immediately improved. In 2016 if you find yourself staring too much at those flashing lights at the top right hand corner of your screen close it out. Your P&L just might improve.

Ilya Spivak, Currency Strategist

Pips Don't Matter, Money Does

As a longer-term trader, I am frequently get questions from novice traders asking how I can stomach risking hundreds of pips on a single trade. I am quick to point out that it is Dollars and not pips that truly matter. After all, a 500 pip loss on a 1k EURUSD position ($50) is far more tolerable than a 50 pip loss on a 100k position ($500). The steady stream of reminders of this basic logic did not help safeguard against a major oversight in my risk management strategy however.

My approach to trade selection begins with cultivating a 6-12 month fundamental outlook that informs which currencies I want to be long, which ones I want to short, and which I want to avoid altogether. From there, I use technical analysis to fine-tune entry and exit prices as well as manage risk. Timing was an early pitfall of this approach. I often traded on fundamental hypotheses before the markets gravitated to their realization. This had me stubbornly holding trades that were not working because I believed in the narrative rather than listening to price action.

In the spirit of Yra Harris' sage advice – "If you're right at the wrong time, you're wrong" – I adjusted by introducing a forced take-profit clause into the system. I would take profit on half of any position once the first technical objective was met and trail the stop-loss to breakeven on the rest, allowing it to play out whatever big-picture fundamental theory with risk largely off the table. I also resolved to accept no worse than 1:1 risk/reward on the initial setup on the premise that as long as my process had a positive edge, this would be profitable over the long term. The problem however, was that I measured the risk/reward ratio in terms of pips rather than Dollars.

This was not initially an issue. For example, the system worked great in 2014 when the US Dollar trended strongly, making for significant follow-through beyond a trade's first target. With a 65 percent win rate, this generated healthy returns. My ability to pick trades seemingly improved in 2015, with the win rate rising to 73 percent. Nevertheless, returns suffered, with realized year-to-date gains trailing significantly behind that of the prior period.

Why did this happen? The markets turned choppy in 2015, with many more trades reversing to stop out at breakeven on the second half of a position after booking small gains on the first. So, while the number of losers relative to winners was smaller in 2015 than 2014, their size was on average larger. It was then that I realized what was happening: on a hypothetical 10k trade with a 50 pip stop and a 50 pip first target where I would book half of the position, I was initially risking a Dollar loss twice the size of the gain.

The lesson here is simple: it is always best to think in terms of money and not pips. Had I done that initially, the adverse skew in my risk/reward strategy would have surfaced. I have now adjusted my approach to accept no less than 2:1 risk/reward in pip terms. This means that on the same hypothetical 10k trade, the 50-pip stop would need to be matched with a 100-pip first target since profits would only be taken on 5k of the position. This way, a true Dollar-based 1:1 risk/reward ratio is achieved, making for a promising strategy if I keep the win rate in the 60-70 percent range.

Michael Boutros, Currency Strategist

Staying Too Close to the Market Can Be a Bad Thing

I often say it's important to keep your fingers on the pulse of the market- a reference to staying close to price action and being attentive to shifts in broader market sentiment. There is a point however, when being too close to the market can have an adverse effect and cloud your judgement as objectivity fades and emotions begin to alter your decisions. Near-term scalpers & momentum traders alike are especially susceptible to this pitfall.

One of the hardest things to do in trading is staying objective. You've heard it before: 'plan your trade and trade the plan.' Indeed some of my best trades have been those where I've mapped out the levels, placed my stops/limits and let the trade pan out. Price watching is a big part of my personal strategy as I look to identify triggers in both price & momentum- But once the trade is taken, let the market do the rest.

An inherit problem with watching prices too closely is the propensity for near-term price action to alter your medium-term outlook. Often time's traders will bring stops in or take a breakeven trade based on fluctuations in near-term price action or prevailing media headlines that may go against their current view on the markets. Even worse, traders who tend to price watch too closely are also more likely to find themselves chasing markets. Whether it's buying a breakout or selling a breakdown, chasing markets is always risky and is often a symptom of a trader who may be price watching too closely. Trusting in your analysis is a key part of trading confidently and keeping your focus on your trading plan is critical. Don't let short-term price action & headlines wavier your bias- a good rule of thumb I like to remember is to 'go cautiously with the crowd, and boldly against.'

Finally, it's important to avoid following too many markets at any single time. The number of active setups one can actually execute is different for every trader. Personally, I've found that closely tracking to 2-4 trades at a time is the ideal approach and prevents me from stretching myself too thin. Remember, markets do not reward the masses and it is our job as traders to maintain discipline and to be mindful of habits that could impact our trading decisions.

Christopher Vecchio, Currency Strategist

Be Willing to Step Outside Your Comfort Zone

My top trading lesson of 2015 isn't so much a confession of a trade gone wrong but rather a reflection on my trading process. In an effort to become more of a rules-based trader, I boxed myself into a few particular strategies – mainly of the medium- and long-term breakout and momentum variety. While this was done for good reason – my trading results historically have proven better for those types of environments than say, range trading or short-term scalping variety – my focus on staying within the parameters of my strategies effectively boxed me out of several of my preferred FX currencies (ones that are reliably highly liquid) for part of the year: mainly AUD/USD, GBP/USD, and USD/JPY.

There are two takeaways in my opinion. While it's good to have a comfort zone – I prefer operating on H4 and D1 timeframes looking for breakout or momentum opportunities – it may be prudent to step outside of that comfort zone if opportunities present themselves elsewhere. This could mean I should have looked at lower timeframes – H1 or H2 – or that I should have expanded my palate to other instruments. The latter choice is the more conservative choice: I have strategies that I'm comfortable with, and I just need to apply them to other instruments.

For me, this issue manifested itself where I was mainly trading EUR-crosses and USD-pairs, so short-term periods of countertrend price action – like from March through October in EUR/USD – proved frustrating as I sat idly on the sidelines for the most of it. Yet had I been willing to shorter-term in these markets, I could have brought my breakout and/or momentum strategies to lower timeframes, with lower leverage (insofar as I would have been trading against the predominant longer-term trend); or I could have looked into trending currencies like the AUD-, CAD-, and NZD-crosses. That's not to say I didn't take advantage of their moves; it would have been prudent to look beyond AUD/USD, USD/CAD, and NZD/USD.

Moving forward, this means that my attention will have to grow in scope. However, what I'll do to assist me is script a quick program to scan technical indicators for me to highlight which FX spot instruments out there meet my desired criteria. Being mindful of my risk management while stepping outside my comfort zone – EUR-crosses and USD-pairs – should lead to more opportunities to trade and thus more opportunities to improve as a trader.

James Stanley, Currency Analyst

Know What You Don't Know: The Future is Always Uncertain

2015 was the year of surprises. We came in with the full expectation that we were going to see a hike from the Federal Reserve, and then spent much of the year bantering about whether or not they should or shouldn't hike. It wasn't just the media debating this or offering their input; we heard from the IMF, the People's Bank of China, and the European Central Bank among many others offering their advice to the Fed. In August, they all warned that a hike would send the global economy into a tailspin. So the Fed didn't hike in September and everything fell to shreds anyways. Multiple Central Banker speeches later, in which the prospect of 'looser for longer' was floated numerous times, and markets started rallying again.

'Buy the Dip' has been the favored strategy on US stocks for the past six years, and of late, even that theme has begun to come into question as we look at the very real prospect of a rising rate environment for the US economy. Buy the dip got up and went with the summer sell-off, and we may be seeing a shift in the market where Central Banks aren't going to be nearly as supportive moving forward.

And this brings us to our lesson from 2015. No matter how strong a trend appears to be, no matter how long a correlation has 'worked,' and no matter what a Central Banker tells you - you have to realize that there are always two sides to every market. The banks and hedge funds that you compete with in the contest of trading and speculation are pretty darned good at what they do. Their job is to make money with their money. So when something is known, it's fairly certain to get factored into price by these players. The supply and demand from such large players in the markets impacts price, and this is what creates price action formations that traders can use to keep them out of these considerably risky scenarios.

This highlights the necessity of a balanced approach. Technical analysis is good. Fundamental Analysis is good. But none of this is worth anything without risk management and a cohesive approach to markets. We will be wrong at times and we will get caught on the wrong foot. We have to be able to mitigate the damage of these situations, or we risk falling into the trap of The Number One Mistake that Forex Traders Make.

So, going into 2016, be careful of what you 'know' from what you don't. While we can all get conditioned to follow behavioral patterns and trends and themes across markets, things change; and as traders, we have to change along with it or we'll watch one 'bad' trade wipe away a large portion of the trader's equity simply because we can't lose a small battle with the goal of winning the bigger picture war. It's this constant state of change that makes the world great, and this will continue to happen as long as Earth remains on its axis.

Tyler Yell, CMT, Forex Trading Instructor

Be Mindful of Sentiment Extremes …Always!

Sentiment could be called the white magic of the FX market. Sentiment about a market is what often carries markets beyond what many expect when a move develops, and the unwind of sentiment is what causes the most shocking moves. Getting 'blown out of the water,' is the terminology often used when a sentiment extreme reverses. A great example would be in March and December of 2015 around the EUR. In March, EURUSD was coming down from nearly 1.40 in summer of 2014 and was trading fast below 1.10, and many believed we were on our way to 1.00 or parity. In December, USD was strengthening in anticipation of a Fed rate hike and further easing from the European Central Bank was pulling EURUSD down from the Black Monday high of 1.1712 back toward what many perceived to be parity.

The Euro moved aggressively higher after the ECB cut its deposit rate on December 3. Why? Looking at positioning data in Futures & FX, we noted that the trade was very crowded and the bar for the ECB to please EUR sellers and encourage more to jump in was too high. This abrupt move was a great example of sentiment getting ahead of reality. The probable is that when reality loses momentum in the direction that sentiment was directionally-biased, sharp moves against the prior trend can develop. Put another (and more succinct way), Jeremy Grantham noted within days of the 2009 equity market bottom, "Be aware that the market does not turn when it sees the light at the end of the tunnel. It turns when all looks black, but just a subtle shade less black than the day before."

I will leave you with this quote to remind you not to get down on yourself if you have found yourself on the wrong side of a sentiment unwind. If the father of calculus and the gravitational theory were unable to understand the sentiment drivers in markets, you should not be too hard on yourself.

"I can calculate the movement of stars, but not the madness of men,"

Isaac Newton apparently said after he lost his fortune investing in the South Sea Stock Bubble of 1720.

As a warning of note, Oil is sitting at extremes, which aligns with other markets that had an aggressive recovery. Trying to time precisely the recovery or turn is nearly impossible and left to the likes of Kristian Kerr. However, when the move occurs after such a strong build in positions, the snap back is often faster and stronger than many expect as another "sure thing" unwinds.

David Song, Currency Analyst

Beware of Stretched Market Expectations/Positions

'Watching Currency Crosses for Underlying Strength' was a key theme for 2015 amid diverging paths for global monetary policy, and the future developments coming out of the major central banks are likely to drive market volatility in 2016 as the European Central Bank (ECB), Swiss National Bank (SNB) and the Bank of Japan (BoJ) stick to their easing cycle, while their U.K. and U.S. counterpart draw up an exit strategy.

Even though the ECB continues to push monetary policy into uncharted territory, the spike in EUR/USD following the December 3 interest rate decision suggests market expectations may have been stretched too far ahead of the announcement and highlights the risk of a heavily crowded trade. The Euro remains at risk of facing headwinds in 2016 as the President Mario Draghi keeps the door open to further insulate the monetary union but, the Governing Council may be less proactive in the year ahead as the non-standard measures work their way through the real economy.

In turn, the reluctance from the community of central bankers to implement additional monetary support in 2016 may drag on investor expectations and spark a further adjustment in market-positioning as the global easing cycle appears to be nearing an end.

Walker England, Forex Trading Instructor

Stick with the Plan

“Should I enter the market here?” I ask myself this question more than any other. The answer is always a straightforward one, and fairly easy for me to tackle. (It should be for you too!) If a potential opportunity meets your trading parameters then I say go for it! If a trade does not meet your expectations, regardless of what your trading friends, media pundits, or anyone else says for that matter I would suggest you pass. Now this answer comes with one small caveat, you must have a trading strategy before you begin trading. Regardless if you trade fundamentals or technicals, this means taking the time and doing your homework before the trading day begins!

Having a trading plan is especially beneficial to technical day traders. When operating on a truncated timetable it often exasperates our decision making process. So as opposed to “winging it”, you now have a set list of parameters to follow ahead of time. This can keep us from making fatal mistakes such as revenge trading, over leveraging, or simply chasing a bad position. Each of these mistakes can be avoided if we take the time to plan ahead of time. The last step in the process is accountability. It of course is one thing to have a plan and another to follow it. I suggest running a statement at least quarterly, and see if you really should have entered into the market. If your trading plan needs adjustments, now is the time to make them and strive to do better and hold yourself accountable in 2016!

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