Discussion Questions

Try them out yourself!

Part 1 - Trading in a Nutshell

1. **What are some of the trade-offs in trading?**
   - Increasing your risk-reward ratio (RRR) would decrease your hit rate. The reverse is true. The trade-off is between your hit rate and your RRR.
   - Also, there is a trade-off between early entry and profit potential. Early entry tends to have more profit, but late entry tends to have less profit.

2. **What causes prices to move up and down in the market?**
   Actual buying & selling (supply & demand) causes prices to move. Sentiment / news is not a direct cause, because at the end of the day it is the actual purchases that causes prices to move. Institutions are responsible for most of the buying and selling in the market.

3. **How do you make the most money in a strong trending market?**
   This is a type 1 market (eg. 2009-2017 stock market). Trade in the direction of the trend when it starts (early entry). To maximize profits, hold the trade even when price pulls back, and keep buying (or shorting) (a.k.a stacking positions) whenever it pulls back..

4. **How do you make the most money in a sideways market?**
   - Type 3 market, wait for a clear & strong breakout.
   - Type 4 market, remember ""buy low, sell high"".

Part 2 - Riding Market Trends

5. **What are the signs of a strong trend?**
   - HH/HL, LH/LL. (higher high, higher low. Lower high, lower low)
   - Steep sloping EMA, price bars mostly away from EMA.
   - Multiple strong trend bars, weak bars in the opposite direction.
   - Bars do not overlap much.
   - Trendlines help as well. Steep trendlines = strong trend.

6. **Why do pullbacks happen in a trend, even in a strong one?**
   There are 2 groups of people:
   - Those with open trades: Profit-taking by trend-followers
   - Those with no open trades: Institutions taking the opposite trade to capture short-term movements

Part 3 - Turning Points in the Market

7. **Is it better to enter a "TURN" setup in the earlier or later stage of the setup? (Tipping point vs. Break neckline)**
   Both are valid trades, but there's a trade-off between profit potential and hit rate
   - Enter early: larger profit potential but less likely to be correct.
   - Enter late: less profit potential but likely to be correct.

8. **Why does the market take longer to reverse down, as compared to reversing up?**
   Honestly, no ""right"" answer, but it helps to have your own understanding of this phenomenon.
   - Greed: People are more cautious buying when prices are high; greed is powerful but people are slow to act on their greed.
   - Fear: However, fear causes very quick reaction and thus market 'crashes'. At the end of a sharp crash, the buyers that got burnt in the crash step aside, and institutional buyers step in to make heroic purchases (since they made money shorting the market crash, and would be glad to buy at such a cheap price.)
   - This applies more for the stock market. The currency markets tend to behave the same at the extreme tops and bottoms.

9. **How do you distinguish between a pullback (temporary correction against the main trend) and a reversal (change of trend)?**
   - Weak pullbacks: probably has a pullback that has low volatility, small width, low volume, doesn't break EMA.
   - Strong pullbacks: probably has a pullback that has high volatility, large width, high volume, breaks EMA.
   - Of course, we are speaking in terms of probabilities, because pullbacks can possibly have high volatility but fail to change the trend.
   - New traders should not trade against the main trend until a ""turn"" or ""break"" setup appears.

Part 4 - Trading Zones & Breakouts

10. **Why do prices bounce off S/R levels? Why do S/R levels change polarity?**
    Buyers and sellers both engage the market at this price for their own reasons, either:
    - Closing open positions,
    - Taking new positions, or
    - Reconsidering their stance (closing some positions, add positions etc.)

    Prices have memory of the past (possibly a self-fulfilling prophecy), or because institutional traders find it to be profitable to engage in the market during those times.
    No 'correct' answer, but it helps to think about it and form an opinion about this phenomenon. of support and resistance.

11. When drawing lines on the chart (S/R, TL), how do you decide the "correct" line to draw?
   - Normally an estimate, a 'best-fit line' is sufficient for trading purposes.
   - 'Close-enough' is good enough (line of 'best fit')
   - Generally at least 3 points of contact for a line to be valid.
   - There are countless market participants plotting countless lines on countless charts, you will never know the exact value of what all the traders are doing.
   - The S/R levels represent the combined actions of these buyers and sellers, and the aggregate effect of everyone's participation would cause there to be support and resistance lines.

12. How do you decide when to enter a breakout? How do you tell the difference between a real and false breakout?
   - First, check if its a type 3 or type 4 market. Type 3 tends to have less failed breakouts.
   - Second, a breakout has 3 components.
     - Before breakout: is there a major support/resistance level that the market is trying to break out of?
     - During breakout: Real breakouts have big trend bars, high volume, compression (something like a squeeze).
     - After-breakout: Is there follow-through? Big trend bars and little overlap?
   - Entering before the breakout - greater profitability, but lower chance of success.
   - Entering after the breakout - less profitability, but higher chance of success.
   - Both cases are valid trades.

Part 5 - Price Action & Precision Timing

13. When analyzing the charts, which is more important - the past 20 bars or the past 200 bars?
   - The answer is BOTH.
   - The past 200 bars shows you the overall context, and lets you know what market type and setup to use.
   - The past 20 bars helps you pinpoint an entry; this is when you look for pullbacks to EMA, signal bars (doji and trend bars), trendline break, breakout bars, high volume bars, smaller wedge/triangle patterns etc.

14. What is the purpose of waiting for a signal bar to enter a trade? Is it always necessary?

There is a trade-off; the signal bar gives you higher hit rate, but reward-to-risk is slightly lower. The signal bar merely serves to give you a trigger for a setup. The only scenario when signal bar is not required, is when the set up is very very good, and no signal bar is required to be profitable.

- Example: Very strong trend, buying/shorting at any price would give you profit.
- Everything else, it is better to have a signal bar, especially the bounce setup!

15. **Why do sharp rebounds occur in the market? (why do sudden change in opinions occur in the market?)**
    - There isn't one answer, but we observe these sharp rebounds very regularly in the market, especially in forex. Most of the trading is done by algorithms run by institutions. When prices move very sharply, institutions could be buying so rapidly that they could be trading the 1-min chart or even the 10-second chart.
    - The machines can trade very rapidly with very low commissions, and in very large volume. This explains why in the recent pound flash crash, a huge sharp down move was followed by an almost 60% reversal within the same day.
    - Longer-term reversals happen when prices are too extreme / climactic, and the consensus for existing traders is to take profits, while new traders decide to trade the reversals.

<u>Part 6 - Practical Execution & Risk Management</u>

16. **You have 2 strategies - one with 60% hitrate and one with 90% hitrate. Which strategy will you be willing to risk more on?**
    Technically, you should be risking below 2% of your accout on every trade, so each trade should already be low-risk in that sense. However, we know the trade-off between hit rate and profit potential: the 90% hit rate trading style would see small profits and big losses, but the 60% hit rate trading style would see larger profits and smaller losses.

17. **Is it better to add or reduce positions as the price moves in your favour? What are the pros & cons?**
    - Again, there is no fixed answer as it is a matter of trade-offs.
    - First, you need to see if your setup is still valid. Your decision is based on whether the trend is still strong, whether the breakout is still strong.
    - Most people take profits too quickly and eagerly. If you are comfortable with this, you can do so.
    - I reduce my position size after a move of at least 1:1 risk-reward, and I take half-profit at the 1:1 level, and trail the rest. It makes trading less stressful because even if the position suddenly goes against you, at least you would have taken profits on half your position.

18. **If you start off with $30k and make a compounded return of 3% every month, how much will you have after 20 years? (hint, use excel to calculate)**
    Answer: $36145579. Calculation: $30,000 x (1.03^(20*12))

19. **If you start off with $30k and you lose 50% in the first 3 months, then go on to make a compounded return of 3% every month, how much will you have after 20 years?**
    Answer: $16,539,162. Answer: $15,000 x (1.03^(237)) →20 years - 3 months = 237 months

Part 7 - Case Studies

20. **What is the biggest difference between theory and application?**
    Looking at setups when they are historical looks obvious, but making the trades can be mentally challenging because the success rate is 40%-60% most of the time. Having a sound plan and sticking to it is simple to say but difficult to do, however, it is the only way to be successful in trading.

21. **What are some of the challenges faced when interpreting a chart?**
    Different people will interpret the chart differently, and you may even doubt your own analysis at times. Therefore, specialize and stick to one style. Don't try to be everything. For example, you can trade the SWING setup alone and be profitable. You don't have to be good at everything, but you have to at least study and understand the different ways to trade before selecting your own style.

22. **Does the uncertainty feel uncomfortable when you have to make a decision based on incomplete information (probabilities)?**
    - The brain is biased to seek certainty but you have to retrain the brain to think in terms of probability. If you can accept this and embrace this as a fact, you will exploit probabilities to make money.
    - Even if you are a skilled trader and everything was done correctly (you chose the right market type, right setup, good signal bar, confluence of factors, good context, good risk management, emotionless execution....) there is still a 40% chance of being wrong. That's just how it is.

Part 8 - Trading Psychology & Consistency

23. **What rules would you set for yourself to prevent yourself from entering the market when there is no good trade?**
    - Give yourself a maximum number of trades per week. (3-5 trades a week). If you are more active, you can limit yourself to 3-5 trades a day.
    - Keep good trading records so you can monitor your trading discipline. If you exceeded the number of trades you are supposed to make, or make trades that actually do not present themselves as a favourable opportunity, it would show up in your records. Your goal is to be a disciplined, consistent, analytical trader, not to make the most money in the shortest time or make a sudden heroic gain from one lucky trade.
    - Do not hope. Trade what you see, not what you think. (Remember the criteria for each setup) If you are hoping, you do not know what you are doing. Remember the market types, setups, and the probability of success.

24. What are some ways to avoid getting affected by your emotions while trading?

- Trade small enough so that you won't be 'hurt' by the loss (1%, or even 0.5% risk per trade)
- Focus on the probabilities, and evaluate them regularly to ensure you success rate is at least 40-60%.
- Focus on your proficiency, not your profits. If you become a better chart reader, you will make better trades.
- Don't trade to find your self-worth. If you lose money, it's not because you are lousy as a person; it's just that trading is a new skill that you are learning, and you may stumble along the way.
- Practice regularly. The more you trade, the more you recognize your mistakes and successes. You will start to see setups more quickly, and you learn about yourself much more because you understand the emotions that you are going through while trading.