TRADING ADDICTS
trading education

Chapter 1

Setting the Groundwork

Understanding Essential Basic Concepts

Investors new to financial markets are often intimidated by the seemingly endless stream of new and unfamiliar terminology and the broad variety of trading strategies that can be employed in the market place. Trading can, and sometimes does, get quite complex. The truth is that it doesn't have to be. An introduction to trading can help new investors get a solid footing to know how to disseminate the never-ending amounts of information, and can help them think about the markets and trading in a way that has failed the majority of individual investors. Our goal is to provide a framework for an overall approach to trading that keeps all the complexities to a minimum, and gives the investor all the tools and knowledge needed to be a successful trader.

At the risk of disappointing some traders, let us clearly state that there is no such thing as a one-size-fits-all approach to trading. Each individual investor comes to the market with a different set of needs, objectives, and risk tolerance. This is why it is critical for them to use some discretion in deciding on the best approach for success. In each module of this training program, a broad variety of strategies, methods of analysis, and approaches to the market will be discussed in great detail. Each of these modules will be applicable to a winning trading approach, but will ultimately be up to the individual as to which methods fit their personality, level of risk tolerance, and general understanding.

Be prepared to be challenged along the way. In this course, our aim is to educate you, and provide you with all the tools you'll need to become a successful trader. It is, however, your responsibility to do the required work, challenge and motivate yourself, as well as to commit to achieving success. You are the most important component to your trading success. If you can unemotionally approach the market and follow a clear trading plan, you'll stand a much better chance of success than if you let your emotions dictate your decisions and trade without structure.

Expectations

As you start the process of your trading education, it's important to gauge your expectations and make sure they are reasonable. Most speculators typically come to the market over a hot stock tip, or an idea that they think will make them wealthy beyond measure. The nature of this same speculator is that they typically are focused on rewards as opposed to risk.

The art of trading is a balance between managing risk and recognizing and capitalizing on opportunity. Because risk is involved in trading, we want you to always understand the risks first; rewards second. While we look to the markets to help us in our journey to financial independence, we must also understand that trading is not a "get rich quick" application. While it is possible that we'll find success, and at times more than we expected, it's also important to expect losses, and plenty of them.

Knowing that you will have losing trades, and planning for it, can help you mentally prepare for how to handle losses and losing streaks as they surface. We'll discuss risk management principals at length in this course, but before moving on, it's imperative to set your expectations at a reasonable level, so that finding success is not hard to achieve.

The best traders and investors out there have posted fantastic returns over their careers. Not only are they beating the markets, but typically doing so by a good margin. Over the course of the last 20 years, the average rate of return for the Dow Jones is roughly 12%, while U.S. Treasuries have averaged roughly 3%. Now you might be thinking, 12% a year isn't going to be hard to beat, but let us show you what some of the most accredited investors have been able to return over their careers:

George Soros- 30% over 30 years
Paul Tudor Jones- 24% over 21 years
Peter Lynch- 29% over 13 years

These individuals have been able to double the average return of the Dow year over year throughout the life of their careers. They are also paid millions of dollars because they are able to generate those types of returns.

Now, you won't be managing the amount of capital that these investors are which means you'll have an advantage of moving in and out of things much quicker than they would. But it's always important to know what some of the greatest players in the game are generating. It helps us to understand that perhaps the idea of turning a small account into a multi-million dollar fund in your first year of trading might be a little unreasonable. But it also tells us that beating the market year over year is something to definitely set our sights on, and work on as a goal over the course of our trading careers.

Goals

For your education to be effective, and to measure your progress along the way, it's important to set goals. Goals can help clarify your objectives for trading and guide your decisions about what kind of a trader you want to be.

In this course we want you to start off outlining goals. As you get deeper into the trading course, and learn more about the financial markets and strategies you are going to trade, you'll adopt more goals and be able to be more specific the further you progress through the course. Start now by brainstorming what exactly you are looking to achieve with this course, and what it will require of you to get there.

In writing down your goals, be specific. Avoid generalizations such as "Make more money," or "Make better investment decisions." These are examples of what many traders are thinking, but they fail to recognize the steps to achieve such broad investment goals. Think about why you are getting started in trading. It might be to supplement income, plan for retirement, replace a current job, etc. Start by thinking about how much money you reasonably need to meet these objectives. When you start to understand your goals and objectives, and the reality of what it requires to reach them, you can start creating a picture of what efforts will be required on your behalf to reach your goals.

For example, if you are looking to generate income, but still require a flexible lifestyle, then you'll want to avoid trading strategies like day trading. Such a strategy requires you to be at a computer for most, if not all of the trading day, 5 days a week. Take some time to think through these things and start to write them down. This will help you personalize this program to help meet your needs.

Activity: Print out this module, and use the space below to start outlining a few of your trading goals.

Goal #1:

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Goal #2:

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Goal #3:

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One goal that we highly encourage you to adopt as your own is to *commit to the program, and to work as hard as it takes until you achieve success.* Not all traders find success in the marketplace. However, the ones that find success all share a common characteristic. It's commitment.

Rather than setting a specific goal for returns in the coming year, you ought to consider a goal that is more realistic for a new trader. After all, we won't know what types of returns we are capable of until we start to put into motion our trading plan. Setting a goal that helps you stay committed to the program will help you consistently improve your trading performance, knowledge level, and skill sets.

Many traders fail to reach their financial goals due to fear of success. They've heard myths of why there are not properly equipped to achieve success. Things such as:

"It takes too much time."

"Investing is gambling."

"I'm not smart enough."

"I can't outwit a professional."

As a famous trader once said, “You always get what you want out of the markets.” If you take time to understand what it is you want, you may realize why you’ve failed to reach your financial goals or realize why you’ve stopped yourself from getting what you want in the past.

Attitude

Winston Churchill once said “*Attitude is a little thing that makes a big difference*.” A positive attitude about yourself, your capabilities, and the process can help increase your chances at investing success. Make no mistake, learning how to trade is not an easy process, but by wearing negative emotions on your sleeve, you’ll start to bring about doubts, discouragement, and frustrations, all of which are feelings that will derail your progress and will make you have second thoughts as to whether or not you are cut out for this.

The markets and the world in general are not always positive in nature. There have been a lot of negative events, negative headlines, and overall general negativity from Main Street aimed towards Wall Street. This isn’t always the case, but there is plenty of negativity out there. It’s up to you to rise above that, focus on your goals, and think positively about <u>your</u> potential outcome.

You cannot control the markets, but you can control yourself.

Selecting a Broker

The first step in the process of preparing yourself to start trading is to select an online broker. As we take you through various strategies, methods of analysis, and other aspects of successful trading, it will be critical for you to go out and practice these methods. This is where the broker comes in to play. Throughout the securities transaction process, the broker serves as an intermediary between you and the markets. A broker’s functions encompass clearing all trades, providing investment advice, recommending stocks, providing market data and information, as well as providing the technology and access to analyze the markets and place orders as the customer sees fit.

The broker transmits your order to the exchange floor, confirms the result of the execution, and looks after your account, tax reporting issues, and all matters pertaining to securities law and regulations.

The final decision on who to use as a broker, however, is ultimately up to you. The consequences of this decision are yours as well. Your broker is not accountable for the profits you make or the losses you incur. Given the important role that brokers play, be careful and thorough in selecting a broker.

When selecting a broker, there are online brokers and full-service brokers. An online broker is a company who carries out buy and sell orders at a reduced commission cost when compared to a full-service broker. An online broker, however, provides no investment advice. For trader’s who wish to do their own research and want to save on transaction costs, an online broker is the best way to invest. For investors who want a knowledgeable individual to help them make sense of the markets, recommend ideas or investments, or make discretionary investments on behalf of the investor, a full-service broker is the way to go.

<u>**Here’s a checklist to help you pick a good broker.**</u>

1) <u>Costs:</u> If you’ve decided to move to an online broker, and plan to be active in the markets, then transaction costs become an important decision when deciding on a broker. If you’ve heard the term “You get what you pay for,” in many instances, this is the case with online brokers. Deep discount brokers might help you save on transaction costs, but they will typically lack in other important aspects. Such as customer service, technology, education, etc. Most brokers are competitive in price, but it’s best to evaluate and compare a few brokers to see where commission rates are at.

2) Reliability of Technology: As technology changes, so do financial markets. In the last several years, the speed of the markets has changed considerably with firms now having the capabilities to execute trades in less than a second. A reliable platform is of significant importance when money is at stake. Research the company's platform. If you find that other customers have complaints about website or platform downtime, reliability, or data issues, it's best not to take the risk.

3) Minimum Deposits: If you are looking to start with a smaller sized account, you need to find out what the firm's minimum deposits are. Some institutions will open trading accounts for very small balances, while other institutions require a large initial capital investment.

4) Customer Reviews: What other customers are saying about the company or individual matters. Just like you would research an investment before placing a trade, you should do the same when deciding who handles your account.

5) Responsiveness to new investors' needs: Don't be afraid to ask what you don't know or want to know. If you decide to use a full-service broker, it's their duty to guide you from the basics to more sophisticated investment techniques. Experience in advisory services is also crucial. You should know the profiles of the officers you deal with: Their educational background, work experience, analytical skills, designations, and their ability to navigate various different market conditions.

6) Product Selection: Not all online brokers offer a wide array of investment products. If you plan to diversify your investments across multiple financial markets or investments, call the broker ahead of time to see if they are able to support the investments you wish to trade.

7) Customer Service: In the fast paced world of trading, there is nothing more frustrating than waiting on hold to speak to a representative at your broker's office when needing help with a trade, or anything else time sensitive in nature. Before you open an account, call customer service and see what the hold times are if applicable.

8) Incentives: Occasionally online brokers will offer promotions to entice you to open an account. They might offer cash, a number of free trades, additional services, etc. At times these extra incentives can be just enough to persuade you to choose one broker over another.

The above factors should all be considered in the selection of your broker. To help narrow the field, we recommend www.stockbrokers.com. They are an online broker comparison site which will enable you to browse the multitude of online brokers and compare. The image below illustrates their comparison process.

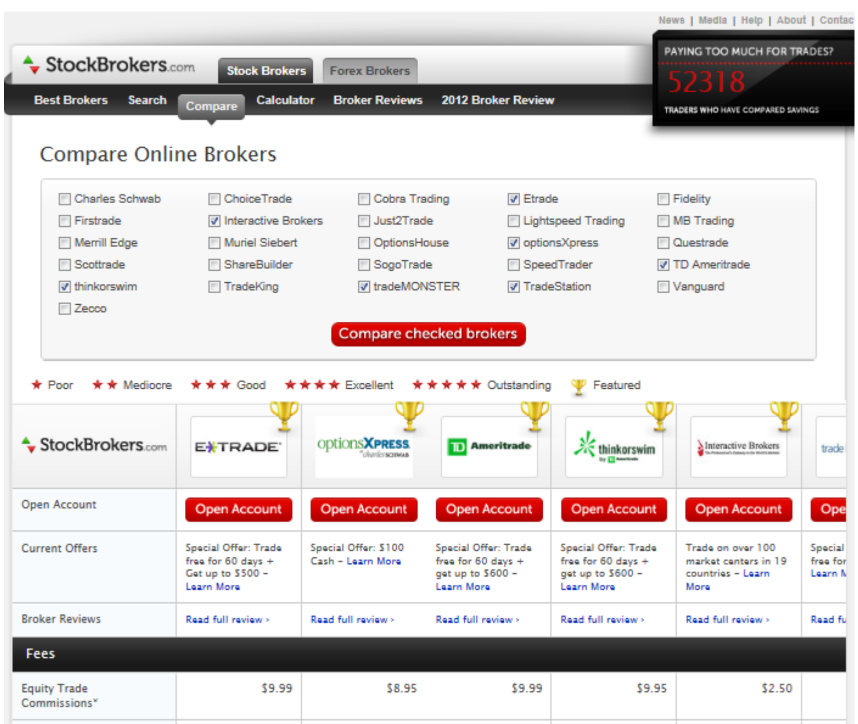

Figure 1: *www.stockbrokers.com Online broker comparison.*

Getting Started in Virtual Trading

Many of the online brokers out there offer virtual trading accounts. These virtual trading accounts help the investor test drive strategies, or just practice trading in the markets without having any real money at risk. These accounts are free to use, and also help investors get familiar with the trading platform and the everyday mechanics of trading.

Signing up for a free virtual trading account can help you test drive trading platforms before deciding on an online broker as well. At the very least, sign up for a free demo account before jumping into a real live trading account, so you can get better acquainted with the technology, order entry process, and position layouts.

Activity: To get started in virtual trading visit www.cboe.com and register for a free account. After completing the registration process, select the "Tools" drop-down menu from the navigation bar, and select one of the following virtual trading platforms:

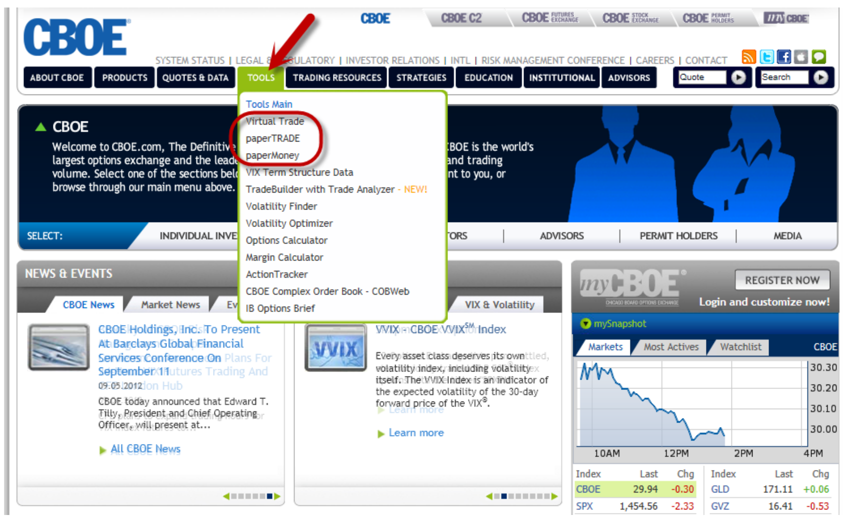

Figure 2: *www.cboe.com Virtual trading platforms*

Virtual Trade – by optionsXpress	paperTRADE™ – by tradeMONSTER	paperMoney – by thinkorswim

As you set-up your new account, take some time to get better acquainted with the tools, information, and layout of the new system. Most of the online brokers will have tutorials available to help you get the most out of their product. Once you've looked things over, start trading! The best way to get comfortable with the strategies and concepts you'll learn throughout our tutorials is to run, not walk, to practice them. In a virtual trading setting, there's no risk!

Start-up Capital

When opening your online trading account, the broker requires you to fund the account at the time the account is opened. The minimum deposit amount will vary across most institutions, but the amount you decide to deposit should be carefully considered. Each trader should be clear up front in terms of what they want to accomplish in trading, so you can form a reasonable idea of how much capital to allocate to your new trading account. Keep in mind that any amount you deposit will be used as risk capital. A trader should only put into the markets what they are willing to risk.

Now that we've discussed expectations, goals, and opening a virtual trading account, we'll start you through the next module on how to create a trading plan.