What Does It Really Take to Succeed?

20 Habits of Wealthy Traders – Part 2

Here is Part 2 of the two-part series, “20 Habits of Wealthy Traders.” In Part 1 we outlined the first ten habits that wealthy traders make part of their daily discipline. In the course of interviewing hundreds of wealthy traders over the past year, we noticed many of them were saying similar things about how they approached the market and looked for profitable trades. When traders who all make over $200,000 per year say the same things, as traders ourselves, we listen. Through hundreds of interviews with traders who make their living in the markets, we compiled a list of 20 habits that are common among almost every wealthy trader with whom we have talked. Some will be familiar to you, others may be surprising. Either way, we hope you will find at least one or two habits you can add to your own trading plan to make more money, more consistently, as a trader. Here are Habits 11-20, in no particular order.

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11. Wealthy Traders Realise the Market Will Be Open again Tomorrow

One thing that always surprises us about new traders is that they often give themselves more grief for missing a trade than taking a loss on a trade. It is absurd, really. They are more upset about having their trading account remain flat than they are if it has decreased because they were in a trade that did not work out as planned.

Wealthy traders understand that their job is not to be actively trading at all times, regardless of the market environment. Their job is to wait for the right trades to come along and actively manage their positions during the right market environment. We see this a lot with traders who have quit their regular jobs to become full-time traders. If they sat in front of their monitors all day at any other job, they would be branded as lazy, unproductive and probably get fired. Therefore, it is reasonable to think that if your job is trading, you must be trading at all times, right? Wrong, and experienced traders are fine “sitting on their hands” until the right trade presents itself.

It is easy to get caught up in the mind set that a certain trade is a once-in-a-lifetime opportunity and if missed there will never be another chance. That is simply incorrect. There will always be another chance to buy an Apple at $110 or short a Netflix at $275. Perhaps the opportunity will not be in those stocks specifically, but the market will offer you another chance at a money-making trade. Relax and get ready for the next trade, it will happen. Do not beat yourself up when you miss what you think was a terrific trade. Rejoice in the fact that your trading account is stable and you did not lose money forcing a trade that was not a winner. Another opportunity is just around the corner.

12. Wealthy Traders Never Add to a Losing Position, Ever

This one really should not need any explanation at all, but we will back it up anyway.

If there is one thing that traders do to decimate their trading accounts more than any other, it is adding to losing positions or letting trades go beyond their stop losses. Wealthy traders do not add to a losing trade, period. They will often, however, add to winning positions. Many traders do the exact opposite in order to “make up” for a losing trade they “just know” is going to turn around. Do not fall into this trap. Add to winners and be ruthlessly impatient with your losers (see Habit #1 in Part 1).

The only exception, and we hate to even mention it for fear it will give you an excuse to break

F1) Never Add to a Losing Position

Imagine you were short in General Motors (GM) from late December. The gap up at the beginning of January would have forced you to close that trade at a loss. If however you decided to add to your short position at this “favourable” price you would have made this trade even worse!

Source: www.tradesignalonline.com

the rule, is when experienced traders with very large accounts have a specific plan to build an enormous position for a longer-term trade in a particular security. Only then might they need to “leg in” to a position to get the full size in place even when their first entry is losing. And only then, if it has not hit their stop-loss, of course.

For 99 per cent of all retail traders, if you never add to a losing position, you will avoid the pitfall that has sent more full-time, at-home traders back to their day jobs than any other mistake. As Dennis Gartman would say, “Do more of what is working” (only add to winners), “and less of what is not” (never add to losers.)

13. Wealthy Traders Judge Their Trading Success on Anything but Money

We are all in this game to make money and hopefully become wealthy doing what we love. Wealthy traders did not get that way by trading for fun. Money is the end game and anyone who says otherwise is a fool. However, money corrupts our decision-making process because it is impossible to remove our emotions and desires for riches from the process of trading.

Wealthy traders know this and will make anything other than money the goal of their trading. For example, one wealthy trader we spoke with judged his success by not breaking a single one of his ten written rules, some of which may be in these 20 habits! He knew that if he did not break his rules and made that the goal of each trading day, the money would simply follow as a by-product of strict discipline.

Traders who set a goal for themselves of making $100, $500 or $1000 per day in the market are destined to overtrade and force bad trades in an effort to achieve that desire. Some days the markets just are not willing to give you that profit. Your specific trading strategy just may not yield your daily goal every day and you will end up taking on more risk the following days to make up for it. That never works.

Instead, set goals for yourself that will result in dollars if followed strictly. That may be spotting a particular pattern while it is developing or getting solid entry prices for your trades. Whatever the goal, make it anything but money and the profits will come to you as a result.

14. Wealthy Traders Read about Mobs, Riots and Human Psychology

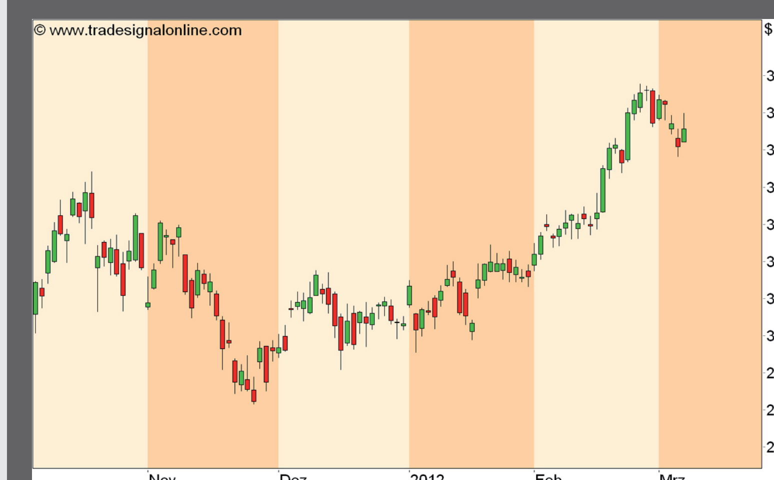
There are hundreds of terrific trading books out there. (“Bloomberg Visual Guide to Candlestick Charting” by Michael C. Thomsett is one the author of this article is reading at the moment.) Wealthy traders read them too and some even write a book themselves. But many of the wealthy traders we talked with realised early on in their trading careers that the markets are driven by human greed, fear and panic – the same emotions that drive rioters to overturn cars and break store windows.

There are several excellent trading books that are not actually about trading at all, but will give you insight into what drives human behaviour in a variety of situations. One of our favourites is, “The Wisdom of Crowds” by James Surowiecki. Another is, “The Art of Strategy” by Avinash Dixit and Barry Nalebuff. And finally, a third book we recommend is “Markets, Mobs, and Mayhem: A Modern Look at the Madness of Crowds” by Robert Menschel.

Books that address the basic premise of human nature will give you new perspective on how supply and demand in any market moves prices, and price is king. Some traders even insist that price, and only price, is what matters. News, technical analysis and depth of market screens only serve to distract us from the only thing that truly matters to the markets – price action.

Whether you believe that or not, educate yourself on crowd mentality and you will better

F2) Did You Follow Your Rules?



It is more important for traders to follow the rules on each trade rather than to make money. If for example your rules say to trade long in a trend of higher highs only, you would not have been able to buy Ebay (EBAY) before mid December which was a few dollars above the low. If you follow the rules your trading will be fine.

Source: www.tradesignalonline.com

understand how to profit from the madness of the markets. It is the secret trick wealthy traders use to drain the accounts of less experienced traders by taking the other side of their trades.

15. Wealthy Traders See Themselves as Market Makers

They may not be market makers in the strictest sense of the word, but wealthy traders do one thing well that all official market makers do – they provide liquidity to the markets. This means they find ways to profit in the market by providing trading volume to the markets with their positions. This is a nuanced point, and a bit confusing to understand so let us use a few hypothetical examples to illustrate this point.

Let us say goat milk is the hot commodity at the grocery store. The local financial news network has stories from the grocery store about how goat milk is the most popular item being sold and food blogs are all talking about the latest price movement in goat milk. You decide you want to be a part of the goat milk craze and head down to your local store. You head to the back of the store, open the refrigerator door and grab two gallons of goat milk. You head back to the front of the store and get in line with everyone else who has their carts loaded with goat milk, signifying you are a newbie trader along with everyone else in line.

The wealthy trader hears about the goat milk craze and also heads down to the supermarket. But instead of heading to the refrigerator to buy goat milk along with everyone else, he goes straight to the checkout line and taps the store employee on the shoulder. "Go ahead and take a break, I will handle the register for a while." The wealthy trader then steps in to facilitate the goat milk transactions and makes a market in goat milk, profiting each time.

Do you see the difference? How about one more example.

Here in the United States, every year at Christmas time there is a hot toy that every child wants. Parents go to extreme lengths to find and purchase the toy for their children, paying double or triple the normal price just to get the bright, shiny object for their loved ones. Not the wealthy trader.

The wealthy trader will go find two or three of the popular toys and negotiate with the seller for the best price for the item. Instead of giving the toy to her children, she proceeds straight to eBay and lists the toy with a 50 per cent markup from what she paid for it. She makes a market for that toy and provides liquidity to the parents desperate to buy it.

It is a small difference in perception of trading that wealthy traders have, yet it makes a huge difference in how they approach the markets and look for money-making trades.

Think like a market maker, not just a trader – wealthy traders do and so should you.

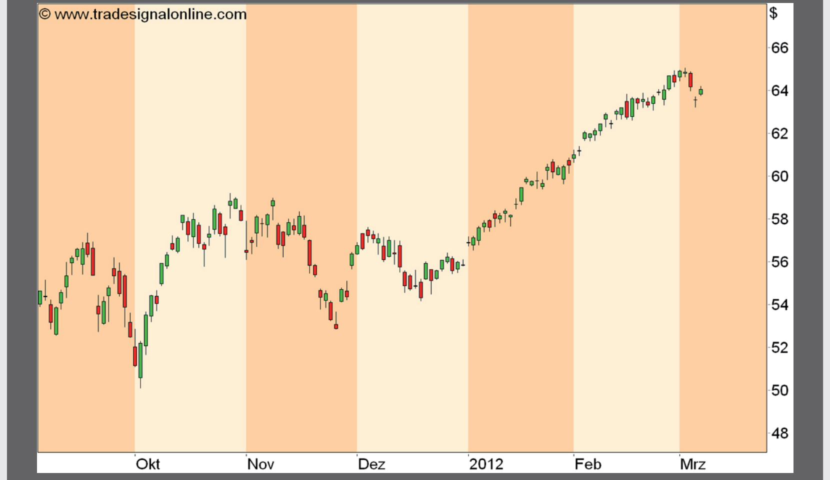
16. Wealthy Traders Practice Reading the Right Side of a Chart, Not the Left

It is easy to read the left side of the chart. Even a brand new trader can spot the "head-and-shoulders" candlestick pattern that happened last month or last year. We can all quickly pick out the "bear flag" or "bull pennant" pattern long after it has occurred.

The trick is seeing those patterns happen as they are happening. The money is made trading that pattern while it is still developing, not two weeks later. Positioning yourself to profit from chart patterns is only possible if you become an expert at reading the right side of a chart – the part that is not there yet.

We are not saying that wealthy traders are crystal ball readers who can predict the future. On the contrary, they see the same exact data we see. The difference is that wealthy traders are able to visualise the next bar and the next after that before it prints on the chart. They see the chart patterns as they are forming and are able to position themselves in a trade ahead of its completion to make money when everyone else catches on and dives into the

F3) Read the Right Side of the Chart



Rather than looking at past prices traders learn to "read" the right side of the chart from experience (here: QQQ). It is important to understand current price action in order to spot trading opportunities real-time.

Source: www.tradesignalonline.com

markets.

Being able to spot chart patterns forming as they are happening in real time takes experience. You have got to watch charts develop for months, sometimes years, in the same security until you get familiar with the behaviour of that security and can tell when a pattern is forming. You can achieve this level of acumen by visualising where the next bar will print before it actually appears on the chart. Surprisingly, the more you do it for a specific stock, ETF or index future, the better you will become at spotting chart patterns emerge earlier than your fellow market participants.

Make an effort to practice reading the right side of the chart, not the left. You can be the best left side chart reader on the planet and it will not make you a penny. The right side of the chart is where all the money is waiting for you.

17. Wealthy Traders Have an "Edge" in the Market

In the movie "City Slickers," Jack Palance's character Curly, tells Billy Crystal's character that the secret to life is "one thing." When Billy Crystal asks what it is, Curly says, "That is what you gotta figure out." Every wealthy trader has discovered what that one thing is for their own account. It is their "edge" in the markets. Without some sort of objective edge in the market, you are simply guessing. Guessing on your trades is not a long-term strategy. It may work occasionally for short periods of time, but if you want to make trading a lifelong career, you must develop an edge.

What exactly is an edge? It is anything you feel gives you a greater than 50/50 chance of determining the future direction of price. If you ask 100 wealthy traders what their edge is you will get 100 different answers. Most traders are constantly searching for the one "Holy Grail" of trading strategies and systems. The "Holy Grail" trading system does exist, but it is not just one thing. It is whatever you find works for you over time to give you a better than 50 per cent chance of entering a winning trade day after day.

For one trader, it may be combining areas of support and resistance, represented by previous highs and lows on a chart. For another trader, it may be combining the "Williams %R" indicator with trend lines drawn on weekly or monthly price charts. The point is, your "edge" is going to be unique to you because you have to be able to spot the best environment to apply your strategy to the market and that is unique to everyone.

Some traders thrive in periods of high volatility where earnings surprises rip a market up and down within a matter of hours. Other traders excel in slow and steady large-cap index ETFs where the normal range per day is a few points. You have to find your "one thing" and capitalise on it with as much size as you can within your risk tolerance.

Without an edge, you are doomed to failure as a guessing trader.

18. Wealthy Traders Determine Position Size Based on Risk, Not Round Numbers

We once asked a very wealthy trader how many shares of stock he bought at a time. He looked us straight in the eyes and said, "That is the dumbest question I have ever heard." After he saw the look on my face, he laughed and explained why. What he meant was that the question about position sizing was like asking a wine connoisseur what kind of wine they liked. They will tell you that it depends entirely on what is being served for dinner. The question is incomplete and cannot be answered without more information.

Are you trading Google at $650 per share or Dean Foods at $13? Only then can wealthy traders tell you what their position size would be. This is because their position sizing is based entirely on their risk management parameters. They decide how much they are

F4) Buy Strength, Sell Weakness

Wealthy traders buy strength and sell weakness. A great example is Apple (AAPL). Who could imagine this highflyer to gap up and rally even more? Maybe not even the wealthy traders. Even though, they would certainly have bought into this amazing strength.

Source: www.tradesignalonline.com

willing to risk in the trade and the volatility of the instrument and then work their way backwards to come up with the number of shares they will buy or sell.

The average trading range for higher priced stocks is likely to be far larger than a lower priced stock. Therefore the position size for a higher-priced stock will likely be much lower because they will have to endure more "wobble" in that stock. 1000 shares of Google (GOOG) is likely to have a much different volatility than 1000 shares of Dean Foods (DF).

Instead of automatically trading 500 shares every time they place a trade, wealthy traders calculate the amount of risk they are willing to take, the average trading range of the instrument and then determine the position size based on those two factors. A nice round number sounds great in theory, but can result in taking on much more risk than you are able to absorb, or less than you should, thereby limiting your profits.

Experienced traders will likely have more complex formulas, but here is a simple starting formula you can use for position sizing: Take the maximum percentage of your account you are willing to risk and divide it by the necessary stop-loss you need to have to give the trade time to work.

Let us use nice even numbers as an example. If your trading account is $10,000, and you are risking a maximum of two per cent of your account on any single trade, your maximum loss would be $200. If your entry price is ten dollars, and your stop-loss is $9.00, you are risking $1 per share. Now, to use the position sizing formula, the number of shares is equal to our maximum loss ($200) divided by our stop-loss size ($1). You can therefore purchase 200 shares. If the stock is less volatile and you feel you can tighten the stop to .50 without getting washed out before the trade has time to work, you could purchase 400 shares ($200 divided by .50). In either case if the stock reaches our stop-loss, and we have to exit the trade, we know we are not going to lose more than two per cent of our total trading account.

This may be an over-simplification for experienced traders with complex strategies, but for nearly all retail traders it is an objective way to ensure you are never taking too much risk on any single trade. Wealthy traders do it and so should you.

There is an online position sizing calculator: http://bit.ly/cmQJX5

19. Wealthy Traders Buy Strong Markets and Sell Weak Markets

Many traders have an obsession with finding turning points in the market. You will hear traders on Twitter and on message boards constantly talking about "trading reversals" and finding "tops" and "bottoms." Yet print out a chart of any stock, ETF, index or futures contract and grab a pencil. Humour me on this little experiment. Draw a vertical line just before and just after major reversals of direction, either up or down. How, how much of that chart is made up of reversals and how much is made up of trend in one direction? I will bet that the majority of the chart, at least 80 per cent, is the area between the reversals where it is trending in one direction. So why do most traders try to make money in 20 per cent of the chart? Would not you rather try trading in the 80 per cent of the chart that is trending in one direction?

Wealthy traders stopped trying to pick tops and bottoms long ago and instead focus on the 80 per cent of the chart that make up the trends. If you find that more than 20 per cent of the chart are reversals or you cannot even decide where to draw your vertical lines, you probably should not be trading that instrument. Look for an easier chart to trade.

Wealthy traders stick to buying strong uptrends and selling strong downtrends. If you are struggling to make money as a trader, we would suggest doing one thing. Buy 52-week highs and sell short 52-week lows. We can assure you those are probably much higher probability trades than you are taking now. Stop looking for reversals at new highs and just trade along with the trend (using your proper position sizing according to your risk tolerance, of course) until that trend changes.

> "Wealthy traders stick to their rules."

If wealthy traders are buying strong stocks and selling weak ones, why are you not?

20. Wealthy Traders Play the Reaction, Not the News

You have seen it time and time again. A company beats earnings estimates heavily and shareholders are rewarded by a sudden move to the downside. Perhaps the good news was not good enough. Perhaps it had a nice run up to earnings in anticipation of the good news and now traders are taking profits. Whatever the reason, it is extremely difficult what the actual reaction to any news will be on a stock until the market shows you what it wants to do.

Wealthy traders know that trying to predict movement of any instrument on news affecting it is exceedingly difficult. However, trading the reaction to that news after the initial move is made is an effective strategy when combined with simple technical analysis.

Also, the initial reaction to any news is almost always an overreaction that can be faded once the market snaps back. This may be one of the only times wealthy traders hunt for that turn, top or bottom on a short-term trade.

Conclusion

Hopefully at least one or two of these habits of wealthy traders will resonate with you and you will add them to your own trading rules. Make all of them habits of your own and you are much more likely to join the ranks of elite traders who make a nice living on their own terms in the market.

Do you have habits you think should be added this list? Write us at http://tradersonline-mag.com/index.php/forum/10-traders-editors and tell us about them. To your trading success!