HOW TO AVOID GETTING BURNED

IN THE MARKETS

FFR TRADING

About Us

FFR Trading is a marketing firm for various investment and trading services. We've worked with dozens of traders in all markets including stocks, options, futures and forex. In a nutshell, we have uncovered the mistakes so many people make when considering trading or investing strategies. Our goal is to find solid investment and trading opportunities that we can pass along to you.

We hope that this eBook can help you avoid some of the same pitfalls many investors fall into, and help provide a primer on the markets, though not a comprehensive thesis on the subject. For advanced education on the markets, we will discuss the unlimited literature available on specific topics.

Table of Contents

Chapter 1 – Understanding the Broker Industry 01

Chapter 2 – 8 Common Investment Tools 04

Chapter 3 – How to Review a Website's Claims 12

Chapter 4 – Market Hucksters and Warning Signs 14

Chapter 5 – Why Legitimate Strategies Fail 18

Chapter 6 – How to Analyze a Track Record 20

Chapter 7 – Hypothetical Track Records & Licensing 29

Chapter 8 – Discover Your Market Personality 32

Chapter 9 – Investor or Trader? 34

Chapter 10 – Trading Psychology: Are You Cut Out for This? 37

Chapter 11 – The Recency Effect 39

Chapter 12 – Keep It Simple 40

Chapter 13 – Do Your Due Diligence 43

Chapter 14 – Real Life Scenarios 46

Chapter 15 – Words of Wisdom 50

Conclusion 51

Chapter 1 Understanding the Broker Industry

To successfully trade or invest in the markets, you need to understand how the players in the trading and investing industrial complex make money. First and foremost are the brokers. They make money whenever you trade. If brokers had their way, they'd like to see you trade as much as possible while helping you win a little. This way, you could keep trading and keep sending them commissions.

Brokers also make money on **"order flow."** They often combine several smaller trading orders and then send them to preferred dealers. For this flow of trading orders, they receive payment.

Some trading systems are purposely designed to over-trade, which makes the brokers who promote these systems very happy. Remember that brokers don't always care whether you win or lose, as long as you keep trading. Think of it like residual income. They convince you to open a trading account, and then make income as long as your trading account lasts.

Brokerages also have an emotional edge because human nature is fickle. People get greedy or fearful and make irrational decisions. This results in over-trading, which then generates more money for brokers and trading software developers.

Similar to Las Vegas casinos, the brokerage houses always have the statistical edge and always win.

Instructions

1. A less-than-reputable broker will lock in your account with a well-known investment, and then pressure you to make very risky moves with urgency. “If you don’t move on this opportunity now, it will be gone forever!” is a line you may hear. Watch out for phrases like “limited time” or “You will only see this once.” A reputable broker will be willing to give to all the information and answer any questionsbefore you purchase.
2. **Churning accounts** is one of the more common ways investors are taken advantage of. This is when a broker has you over-trade your account. Remember, the broker only makes money when your account makes trades. Therefore, they want you to make as many trades as possible. They will suggest this strategy as being less risky, because you are not holding trades very long.
3. **Breakpoints,** most commonly seen in mutual funds, are discounts to the commissions based on the amount invested. A dishonest broker will invest an amount of capital only up to the breakpoint, because one dollar more would lower his commission. Reducing the funds being spread out over many companies will help take advantage of the discounts.

4. Don't be scared to question your broker's advice. If he is reputable, there won't be issues with fully explaining the investment advice. If there is any push back, that could be a red flag. Trust your gut!
5. It is your responsibility to check your accounts on a regular basis. You don't need to be consumed with checking daily, but at least a couple of times a month. It is very seldom we allow our friends to walk around with our wallets without checking to see if everything is in place. Why wouldn't you make sure your broker is doing the right thing?

Suggestions

- If you have questions regarding commissions, don't be afraid to bring them up. If your broker is honest, they won't have issues addressing them.
- Take the time to fully read new account documents. If a broker acts like this is a burden, you are with the wrong broker.
- If a broker is unwilling to provide written information this is generally an indication that they aren't telling you everything.
- Watch out for high frequency trading and churning of your account.

Chapter 2 8 Common Investment Tools

The purpose of this section is not to cover each tool in detail, but to briefly highlight the pros and cons of each strategy so that you can make a more informed decision about which investment or trading vehicle is best for you. Keep in mind that entire books have been written on some of these subjects. The eight subjects are:

1. Brokerage Accounts
2. Auto-Trading (monthly, annually)
3. Managed Accounts
4. Self-taught (books, DVDs, educational courses, gurus)
5. Market Newsletters
6. CTAs – Commodity Trading Advisors
7. Financial Advisors
8. Real Estate Investing

Brokerage Accounts

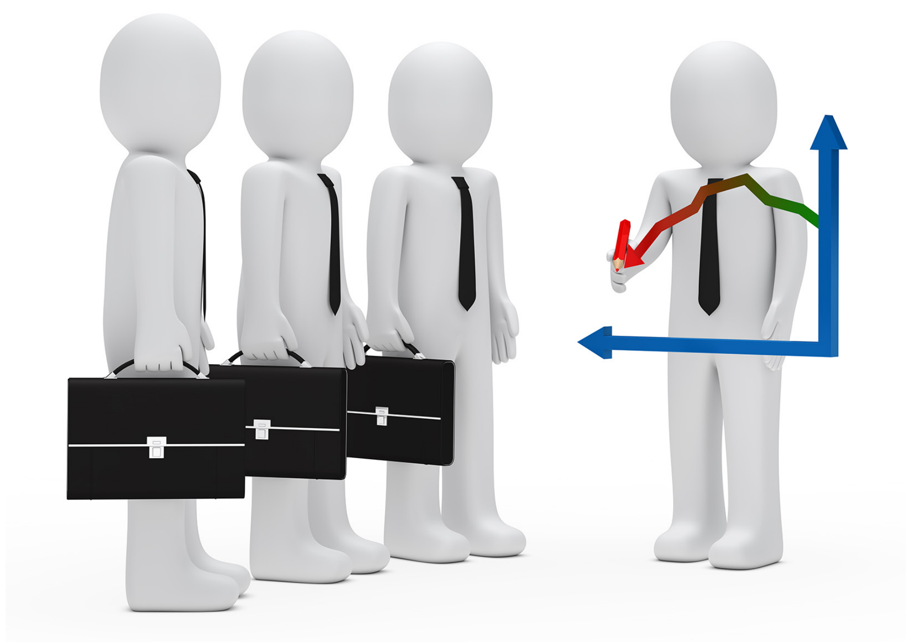
To trade in any market, you must have a brokerage account. A brokerage account is an agreement between a brokerage firm and the investor. In it, the investor is allowed to deposit funds and place investment orders through the firm. The brokerage then acts on the behalf of the investor and handles the transactions. The assets in the brokerage account are owned by the investor, who is usually required to claim capital gains from the account as income.

Pros

Brokerage firms are licensed and regulated, and are required by law to tell the truth. In addition, trading commissions are often negotiable, which many people are unaware of.

Cons

Brokers are in the business of making money, and that only happens when you place trades. Unscrupulous brokers may call you when they want you to trade, saying things like, "You really should consider buying NFLX right now." This tactic is called "churn and burn." The more trades you make, the more commissions a broker makes. A bad broker doesn't care if you win or lose, only that you are trading. The bottom line is that brokers typically do not have your best interests in mind.



Auto-Trading

Monthly Subscription

Auto-trading, also called automated trading,is a service offered by many brokerage firms which allows a broker to place trades on your behalf. You don't have to manually execute the trades yourself; instead you allow a trader or signal service to send signals directly to your broker who in-turn enters and exits the trades. Most brokers don't charge extra for offering auto-trading. Companies who sell auto-trading subscriptions do not have to be licensed or registered with any regulatory agency.

Pros

Auto-trading signals are usually inexpensive. Monthly costs on average range from $50 to $200 per month. You generally get to keep 100% of profits made in your account. In most cases there are no long term commitments. You can buy signals month-to-month and cancel at any time.You don't have to watch the markets all day, and you won't miss a trade.

Cons

Monthly trading signals are not always designed by professional traders. Software developers looking to make a quick buck can bang out numerous auto-trading systems. Many people who buy monthly auto-trading signals have a "get rich quick" mentality and only subscribe for a short period, such as one to four months, and then quit when their tiny account hasn't doubled. Many quit just after one month. The truth is that one month is simply not enough time to gauge possible long-term success of any trading system. Additionally, many auto- trading signals don't work over the short term. You might join the program on a down month while the next subscriber joins on a winning month. The reality is that you need to give it time, and your trading account should to be large enough to allow you to trade the system over at least a year. More on trading account size in chapter five.

Annual Subscription

Some auto-trading systems are sold on a yearly basis. You commit to a full year of receiving and acting on all trading signals which encourages you to give a strategy time to perform.

Pros

With annual subscriptions the caliber of the trader is usually higher. A trading professional trades your money via auto trading through a broker like he trades his own money. If he buys Microsoft, you buy Microsoft. A twelve month subscription is often sufficient to recoup the cost of your subscription and make money – but not always. You also get to keep 100% of profits. In addition, sometimes there are performance guarantees and tax write-offs that can be classified as educational materials or research.

Cons

Yearly auto trading subscriptions are expensive, and you are locked in to a 12-month contract. If you exit early, you deny yourself the ability to recover the losses that compelled you to exit. This is especially true of breakout trending systems.

Managed Accounts

A managed account is an investment account that is handled by a professional financial manager but is owned by an individual investor.

Unlike auto-trading signals which are sent out to all subscribers, managed accounts are personalized investment portfolios tailored to the specific needs of an account holder.

Pros

There are often no upfront fees to get started with a managed account, and you receive a percentage of profits based on a high-waterbenchmark.

Cons

Managed account brokers make commissions based on number of trades and percentage of profits. Their interest, similar to that of brokers, is often to "churn and burn" the account. So even if you lose, they get paid.

Self-Taught

This is the do-it-yourself approach to trading, where knowledge is gained by reading books, buying video courses, attending seminars or online webinars by trading and investing gurus.

Pros

Instead of blindly trusting someone else's trading system, if you find a proven strategy, you can learn the details of the technique yourself and trade it at will. You have the ability to go back and constantly review to re-educate yourself. Ideally, you learn how to trade yourself rather than relying on the expertise of another. There are also tax advantages to this approach.

Cons

In most cases, a "simple, proven" technique from a trading or investment guru is not easy to apply on your own. There are many nuances to each technique that can never be conveyed in a classroom setting. They can only be learned in the school of hard knocks, i.e., a live trading environment with real money. Most

trading and investment books don't include an actual step-by-step road map to real trading, and are instead just general information that you can find anywhere. Books, DVDs and webinars can't teach real world experience. The bottom line is if trading and investing on your own was easy, everyone would do it.

Market Newsletters

Market newsletters are newsletters you receive via regular mail or e-mail that offer market insights and trade picks.

Pros

Market newsletters are usually affordable, and some good ones do exist.

Cons

The challenge with market newsletters is that even with the good ones, it's all in the numbers. You may not always be able to trade every pick that'srecommended. If you happen to miss a big winner or string of winners, but take the losing trades, you may end up losing money on your account, even though the overall newsletter gains are positive.

If a newsletter offers 60 trades a month, will you really be able to take them all? The trades you end up selecting can radically skew your returns. Market newsletters can often show deceptive track records. They fail to consider appropriate account size, market slippage, and commissions. Some track records show compounded returns which is even more deceptive.

Commodity Trading Advisor (CTA)

A commodity trading advisor (CTA) is an individual or a firm, registered with the Commodity Futures Trading Commission, who receives compensation for giving people advice on options, futures and the actual trading of managed futures accounts. Registration for CTAs is done through the National Futures Association, a self-regulated organization responsible for reviewing and accepting registrations.

Pros

CTAs must be licensed and are regulated by the National Futures Association (NFA). CTAs can use different strategies to trade, and good ones will utilize the ones that work the best.

Cons

CTAs sometimes show compounded returns. Compounded reporting, where profits are pyramided on top of one another to show large gains, is misleading and skews results to show higher returns. As an investor, if you are unable or unwilling to compound your account to place the recommended trades, you will not achieve the same results.

Certified Financial Advisor / Planner

Certified Financial Advisors are required to take challenging exams in financial planning, insurance, taxes, estate planning and retirement. They must also complete annual continuing education programs to maintain their certification.

Pros

Certified financial advisors tend to be traditional and conservative with their investment strategies. They look at your long-term goals and retirement considerations. Returns may yield 8-10% per year. Certified financial advisors are usually cautious since they have vested interest in preserving your capital to retain your business for many years.

Cons

The single largest con is the Investment Act of 1940, which mandates keeping clients invested even in a down market to help avert another Great Depression. Remember that financial advisors make money on how much you invest. Keep in mind that they get paid regardless of whether you make money. They may make 8-10% per year for you, but this does not include their fees. Their investment strategies may be built on computer models, not on actual trading. Financial planners won't show you actual client accounts, only projected returns based on their modeling. It's a fallacy to say that financial advisors offer more protection. Buying and holding for the long term isn't always a safe strategy. This approach means high exposure to your account.

Real Estate Investing

Real estate investing is simply the process of buying property at a low price with the hope of either making monthly lease income or by selling the property at a higher price.

Pros

Prudent real estate investing can result in consistent monthly income if you are able to find regular tenants. If you are able to acquire distressed property at a low price and have the money to fix it up, you can "flip" the property for a fast profit in a relatively short period of time. Many people simply do not have the resources to buy real estate in a down economy, but if you do, it's obviously a good time to buy. However, as you can see, there are a lot of "ifs" involved.

Cons

Real estate investing requires home repairs, maintenance and dues. You also tie up liquid capital when you are fully invested in a property. Many people think real estate is a "sure bet" or a "conservative" investment. These terms couldn't be further from the truth. Ask any real estate developer. They will tell you that it could be a great investment, but the possibility of losing your shirt is very real. You may buy a property, thinking the real estate market has bottomed out, only to see property values drop even lower.

Chapter 3 How to Review a Website's Claims

Here's a short checklist to use when evaluating a website's declarations about its trading or investing successes.

- Does the site look professional but lack honesty?
- Are there outrageous claims and sales hype?
- Is there an "About Us" page? If so, is the description generalized mumbo jumbo about how they want to help you or is it specific information about the owners and history of the company?
- Does the website say how long the company been in business?
- Is there a live chat feature? Try it out. Ask hard trading questions. Don't back down.
- Are there names and photos of real people on the site? Are these people active elsewhere on the web? Blogs? Forums? Facebook? Google their names and investigate.
- Is there a phone number on the website you can call? Does a live person answer?

- If you get a recording when you call, leave a message, and note how long it takes for you to get a call back.
- Send an email or complete the contact form. Note how long it takes to get a response.
- Locate the trader's name, company name, and parent company name on the website. In some cases, a company's name won't match its domain name. Review the terms of service and privacy policy to see if you can discover the real owner behind the website. These links are usually at the bottom in the footer area. Google the company name.
- Go to **www.WhoIs.net** or **www.BetterWhoIs.com** to find out who owns the domain.
- How old is the domain? Does this information match what is on the website? Call the phone number and send email to the WhoIs information. See if you get a response.
- If the website claims to be licensed, verify this by going to the links on page 18 of this book.
- If you find "customer reviews" on other websites, copy and paste a sentence or two from the review directly into the Google search box. If you see many identical review results pop-up, it's possible that this review is bogus, and is simply being promoted on multiple bogus review sites to dominate the top results on Google and to push down real reviews from real people.

For long term monitoring of a company, sign up for Google Alerts. This is a free service from Google that notifies you whenever a certain combination of words appears on Google. For example, you could set up an alert for "holy grail company." Whenever Google discovers this phrase is used anywhere across the web on any website, you'll receive a notice with a link to the article.

When waiting for results, keep in mind that it's entirely possible you won't receive an alert if no report is written about the company, and that's not necessarily a bad thing. Give it a little bit of time, and see if you're satisfied with the results. If everything checks out, feel encouraged to schedule an appointment to see what the company can do for you.

Chapter 4 Market Hucksters and Warning Signs

In this chapter we'll briefly cover some of the various ways that market hucksters will try to hustle you.

How Real Traders and Investors Think and Act

Real traders and successful investors who promote themselves don't have anything to hide. They are comfortable with losses because they know that's part of the business. Their track records show all losses. They know their weaknesses and strengths, and will readily admit both in the interest of transparency.

Liar, Liar?

The most basic way scammers try to rip you off is by the simple act of lying. They offer completely bogus trading track records, fake testimonials, fake positive reviews and will say or promise just about anything to separate you from your money.

Some scammers hire people to write fake reviews. When you read the reviews, they'll often sound vague and lack specifics about the trading system or investment strategy in question. The grammar may also be poor. Sometimes the reviews just flat out make no sense at all. If you see dozens of these kinds of reviews you can

almost guarantee that something is amiss.

Another trick scammers use is showing incomplete track records. These track records may exclude deep draw-downs (losses) or even catastrophic system failures.

The Bait and Switch and the Pump and Dump

Bait and switch is another ploy. The huckster presents one track record using a certain strategy that that worked years ago, but no longer works now. After you sign up, you may receive signals based on an entirely different strategy.

Pump and dump schemes are popular in the penny stock world. You receive a newsletter or email telling you that a certain stock is about to explode. The newsletter is jam-packed with images and graphs and "facts" about why this stock is going to the moon. Buy! Buy! Buy!

The reality is that the scammers already own the stock themselves and are looking for naïve buyers so they can exit the stock at a higher price. What typically happens is that a few months after you buy the stock, the share price drops substantially, and you either end up with a worthless asset or end up selling for a loss while your broker makes a hefty commission on the sale. The spread (the difference between the buy and sell price) is usually quite large with penny stocks.

No Evidence, No Success

Other scammer warning signs include no track record at all, no recent track record, a track record that shows large time gaps (months are missing), a track record with no losses, or a track record that covers a very short period of time.

One tricky tactic is to display a track record that seems to be genuine at first glance, but as you study each trade individually, you realize that no human could actually execute the trades that the system generated. There might be hundreds of trades that each make a few pennies. The reality, in most cases, is that broker commissions would destroy any of your profits, and you'd end up losing your money.

Other common red flags include a delayed or no response to email or phone inquiries and a failure to answer even the most basic questions about the trading system or track record. Stay away from sites that have no phone number.

If you do get a "trading guru" on the phone and begin to ask specific questions about his track record, he may get defensive. A common ploy is to explain away his track record, or lack of one, by claiming he now is an educator.

Exceptions

Before you go and write off all traders and investment gurus, please know there are exceptions. Traders and investment gurus on the web are not always the best marketers. Sometimes their websites are just plain lousy, but not on purpose. They are busy trading and developing new trading systems. This is a good thing. In fact, sometimes a website from a trader isn't all slick with sales hype. Upon digging deeper it's not uncommon to discover a real trader underneath it all.

Legitimate traders are busy trading or trying out new systems. They don't always make time to update their website or track records, or gather testimonials and solicit web reviews from happy customers. Additionally, just because a track record is new doesn't necessarily mean the system is not viable. A new system by a veteran trader is worth a serious look over a new system by a new trader any day.

Lack of testimonials doesn't always mean the service is bad. Even a bad review on the web somewhere doesn't mean the service is a scam. People are emotional by nature. Sometimes expectations were simply set too high, or they traded only a couple months but expected a yearly return right away. People might subscribe with the hopes of getting rich overnight. Maybe a company's employee was rude to a subscriber when he called in or maybe he bought emotionally and got cold feet.

The point here is to use your own discretion, and don't throw out a good trading system or investment strategy because of a lame website or a lone negative review. Instead, look at the whole picture.

Chapter 5 Why Legitimate Strategies Fail

Even seasoned traders and legitimate trading systems can fail despite every precaution. Here are a few reasons why:

Seasonality

Trading systems are often designed for a certain kind of market, maybe trending, or sideways. When a trending markets changes to sideways markets, a trend following the system starts to fail. When a sideways market starts to trend, then sideways systems fail. If a trader or system manager does not act quickly enough, a trading account can be wiped out.

Economic News or Global Events

Catastrophic events can wipe out traders and investors who are in the markets. A tsunami, act of terrorism, extreme drought, death of a world leader or resignation of a company's CEO can all cause severe swings in the market. Extreme events are often referred to as "black swan events" since they are so rare.

Technology Failures

Sometimes something as simple as a software failure or a computer virus can cause havoc within a trading system. Trading losses then accumulate through no fault of the trader's system.

Laziness

Lazy traders and money managers may fail to adapt their systems to the ever-changing markets. If they don't change their strategies to fit the new market landscapesor new rules and regulations, losses will occur.

Arrogance

Emotions can get the best of people. When arrogance takes hold of otherwise objective investment gurus, watch out. Newly successful traders can become un-teachable, and start over-trading. Even worse, they develop a Superman complex and think they are impervious to severe losses. An important rule of thumb to remember is that if you aren't humble when approaching the markets, the market will humble you. In the grand scheme of things, you're making educated decisions based on the data. However, if there's anything history has taught us, it's that occasionally not even the best data can be an accurate determiner of what will occur. Stay humble and aware and you'll increase your chances of success.

Chapter 6 How to Analyze a Track Record

In this chapter, we'll tackle some important factors when analyzing performance history.

Preparation

Some websites display track records in table format on a webpage or as PDF downloads. These can easily be imported into Excel where you can do your own calculations based on the concepts below.

Realistic Returns

"Realistic returns" is a relative term when it comes to the markets since many factors can affect overall return on investment. Which market is being traded? Is a trend or non-trend strategy being used? What is the time frame for the system, intraday, daily or weekly? Here are some general guidelines for realistic returns that we've seen over the years:

If you come across websites claiming returns that are more than 100% ROI average per year, watch out – you might have come across a scam.

Trade Profile

It's important to examine trade time periods. Count the total number of trades on the track record and divide by its time period to calculate the number of trades made per week, month and year. This will help you see the average length of each trade. Is it two days or two weeks? Are there too many or too few trades for your taste?

Risk to Reward

“Risk to reward” is the amount of money you risk per trade compared to the average likely return. Another way to determine the same thing is to reverse the numbers. This is a profit/loss ratio. Some experts claim thata good profit/loss ratio should be at least 2:1. This means your winning trades are twice as big as your losing trades. For every $100 you risk, you stand to gain $200 or lose $100.

To calculate profit loss, take the average winning trade and divide it by the average losing trade. In the example below, for every $2.4 dollars you stand to gain, you risk $1:

- Average winner: $523
- Average loser: $218
- Profit/Loss Ratio = 2.4

It’s important to keep in mind that a profit/loss ratio is only one component to consider when evaluating a trading system. A trading system could have a poor profit/loss ratio of 1:2 (for every $1 you make you lose $2), but if you win enough trades overall compared to the number of trades you lose, it could still be profitable.

Winners vs. Losers

This is a simple calculation showinghow many trades are winners and how many trades are losers as a percentage. Generally a ratio of winners to losers should be at least 50% or higher. For example, if there are 100 total trades and 55 of them are winners – the system has a 55%-win ratio and a 45% loss ratio.

It can be psychologically challengingto lose more than you win. There are great trading systems out there that have more losing than winning trades, but you need to have thick skin in order to stick with them.

Profit Factor

The profit factor is a great gauge that combines both profit/loss with the number of overall winners versus losers as outlined above. In other words, the profit factor is a ratio that considers every trade of the track record over time. It shows, on average, how many dollars you make for every dollar you lose.

To calculate profit factor, multiply the number of winning trades by the average dollar amount for each winning trade. Do the same for losing trades. Then divide the winning dollars by the losing dollars to get your profit factor.

For example, let's say out of 100 trades, the system wins 50% of the time. The average winning trade is $10, and the average losing trade is $5. For winning trades we get: 50 x $10 = $500. For losing trades we get: 50 x $5 = $250. Now divide $500/$250 = 2.00. This system consistently makes $2 for every dollar it loses. In short, that means this system looks pretty good.

Required Account Size

How much money is used to derive the track record in question? Is it $10,000, $25,000, or maybe $500,000? If the track record account size is large, could you realistically take the same trades with a smaller account? If not, then don't expect to make the same returns. You want to compare apples to apples.

Account Percent Risk

What percent of your total account is at risk on any one trade? Recommended percentages vary from expert to expert, but here are some general guidelines.

- Conservative Risk: 1% to 5% of account on any one trade
- Moderate Risk: 2% to 3% of account on any one trade
- Aggressive Risk: 4% to 10% of account on any one trade
- Super Aggressive Risk: 10% to 25% of account on any one trade

The higher the percent of your account you risk on any given trade, the higher the probability that your account could be wiped out more quickly with string of consecutive losses. If you risk 10% on each trade, ten losing trades in a row willmean you are done trading.

Leverage

Some track records for options, forex, and futures markets factor in leverage. “Leverage” is the useof financial instruments or borrowed capital, such as margin, to increase the potential return of an investment. If you use leverage to make an investment and the investment moves against you, your loss is much greater than if the investment had not been leveraged. In the futures market, you may receive a margin call and be required to deposit additional funds to your account in order to avoid exceeding acceptable margin levels. Leverage magnifies both gains and losses significantly.

If the track record you are evaluating uses leverage, keep in mind that risk is greatly increased. Only you can decide if thatsystem is too risky for you.

Long-Term Reliability

Ideally, a good track record shows hundreds of trades over a long period, and time frames vary based on trade frequency. For a day trading system, you might want to see a year’s worth of trades, while a good position trading system may show five to 10 years. How reliable is the track record from month-to-month or year-to-year? Is the track record over time too volatile for your liking? Are some periods really bad and some really good, or is there a consistency to equity growth? Can you ride out the down periods, or will the stress be too much for your individual personality?

Drawdowns

Drawdowns refer to periods of time where money lost on losing trades exceeds winners. On a chart you'd look for declines from peaks to troughs. Drawdowns help you determine overall risk to reward. In a nutshell, during draw downs, you lose money.

Questions to ask are: How severe are drawdowns? What percent of account equity is lost? How long are drawdowns; weeks…or months? Do drawdowns exceed your personal risk tolerance?

Position Size

Position size refers to how much money is spent on an individual trade and is usually based on the probability of return. For example, if a trade setup has a higher statistically probability of winning, then instead of buying 100 shares of a stock, a trader might buy 500 shares on that particular trade. Position size is often reduced for riskier trades.

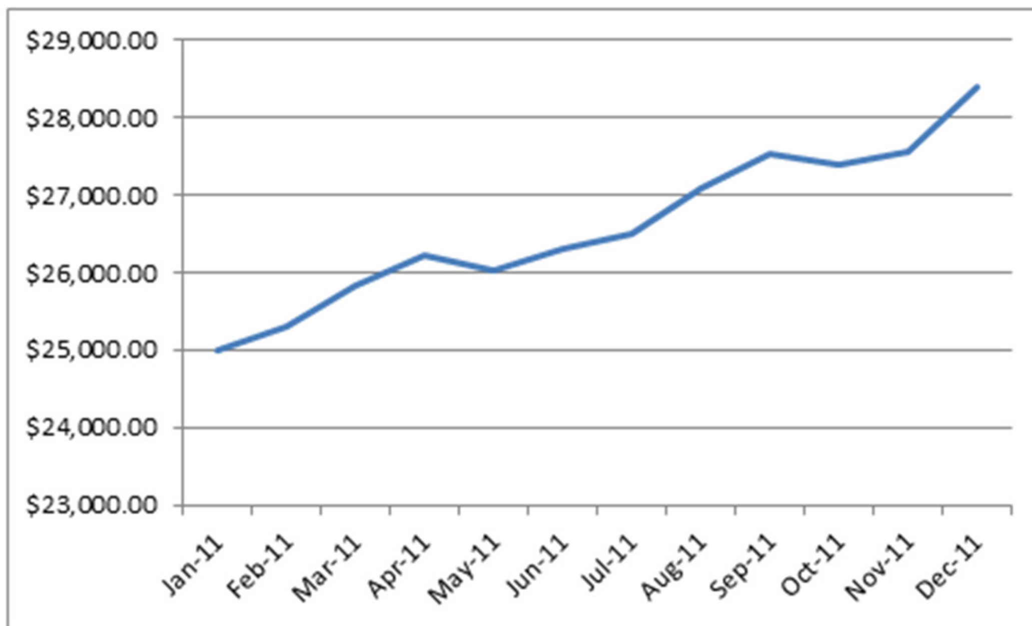
Position sizes can easily skew a track record. As you review each trade, note the position sizes. If position size varies dramatically, you'll want to check to see if you are notified about when to increase or decrease your trade size when you subscribe to the trading service.

Consecutive Winners vs. Losers

Do you see long periods of winning or losing trades on the track record? Count up the average number of trades in the losing periods. Can you sit through these strings of losers or will it be just too painful? Is this your kind of trading style?

Equity Curve

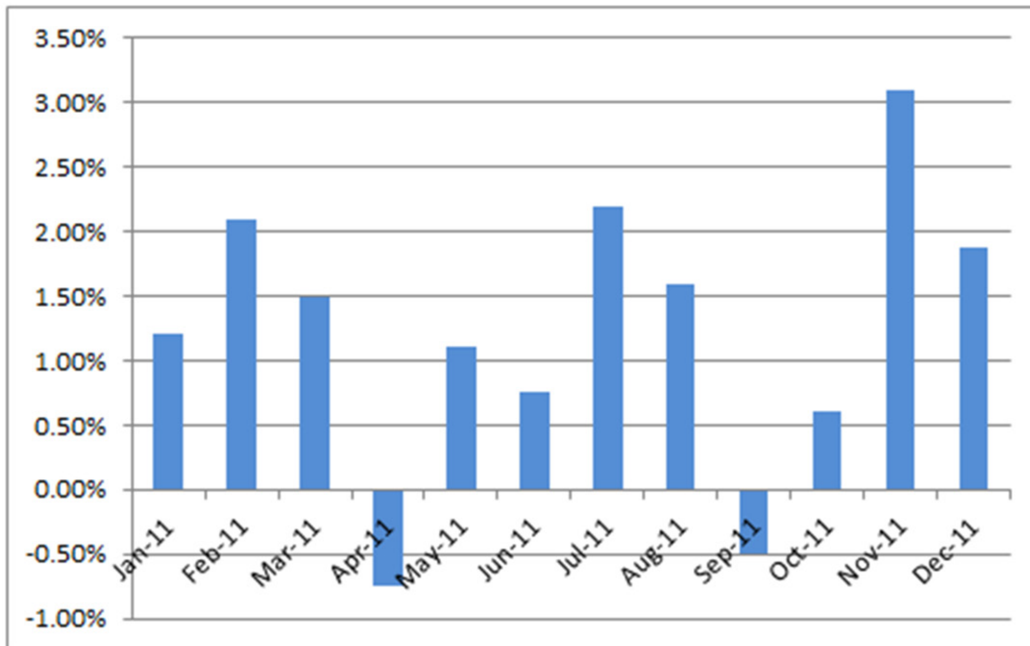
A picture is worth a thousand words. Below is an example equity curve. An equity curve is simply a graph over time of a trading account's value based on a trading strategy. A graph that is consistently rising indicates a strategy that's profitable while a graph that declines means a strategy is losing money.



In the example above, starting capital is $25,000. After 12 months, the account has grown to $28,402 – a yearly return of around 14%. Take note of up-slopes, down-slopes, and plateaus. Note the drawdowns in April-May and in Sept-October. An equity curve should generally outline what you should expect to happen to your own account if you trade the system in question with real money. Is the equity curve growth consistent, erratic or not aggressive enough for you? These are questions only you can decide for yourself.

Histogram

A histogram is another way of displaying trading data that helps you discover daily, weekly andmonthly patterns. In the example below, we see the same 12 months' worth of data showing percent return each month. There were two negative months (April and September) and one outstanding month (November).



Broker Statements

Ask for a client's actual brokerage statement showing the 200 most recent consecutive trades using the strategy being promoted.We emphasize "recent" and "consecutive" so that there can be no funny business. There is no refuting the hard proof of real trades on a verified broker statement.

Go With Your Gut

After all this logical analysis, what does your gut say? When you put the track record under the microscope, do the returns still seem realistic? Does the trading system and risk level fit your personality? Would you be happy with half the returns the track record claims to offer?

Hopefully these tips will help you analyze track records more effectively.

Chapter 7 Hypothetical Track Records & Licensing

In this section we'll use a hypothetical Q&A to discuss several legal issues that crop up on websites that offer trading or investment services.

Question

What is the difference between a hypothetical track record and a real one?

Answer

In the purest sense, a truly hypothetical track record is based only on back-testing. The trades shown never took place in live markets. The data used to test the trading strategy is only historical. These kinds of track records aren't all bad. Just keep in mind that they have no forward history in the markets. If you decide to trade these strategies with real money don't expect the results shown from the back-tested data.

Also consider that hypothetical track records are often "curve-fitted" to maximize gains, but could never really be traded in real life. The system developer keeps fiddling with the rules and settings in order to maximize profitability over the period of time being tested. There is no guarantee that this "over-optimized" system will work just as well going forward with real money.

Question

Some track records seem to show legitimate, "real money" trades, yet they still have the hypothetical performance results disclaimer on their website, or even say that the track record itself is hypothetical. This makes no sense. Why do they do this?

Answer

It's important to realize that hypothetical does not always mean the trades you see on the track record are not real. Due to federal regulations by the CFTC and SEC, all track records are requiredto have the infamous "hypothetical disclaimer."

The reason for this is that technically not every single person who placed the

same "real" trade as shown on the track record entered the trade at exactly the same price or sold at exactly the same price. According to the regulators, even less than a penny's difference makes the trades "hypothetical."

Question

When are traders or investment firms required to get registered or licensed?

Answer

They are required by law if they offer specific advice tailored to your specific investment needs, or if they manage a large amount of money. For example, anlicensed advisor may tell Mr. Smith to buy Microsoft stock based on his specific investment goals, and tell Mrs. Wilson to buy Walmart stock based on her specific investment goals.

Do Your Research

To research the licensing of individuals and companies, please utilize the following links:

For someone who claims to be a Registered Investment Advisor:

Securities & Exchange Commission - SEC

http://www.sec.gov/investor/brokers.htm

For someone who claims to be a Commodity Trading Advisor:

CFTC – Commodity Futures Trading Commission

http://www.nfa.futures.org/NFA-registration/cta/index.HTML

Question

Why aren't all investment or trading-related websites required to be registered or licensed?

Answer

They don't offer specific, personalized investment advice tailored to each particular customers' needs, and they rely on what is called the Publisher's Exclusion from the definition of Investment Advisor as provided under Section 202(a)(11) of the Investment Advisor's Act of 1940 and corresponding state securities laws. These websites publish general and regular circulation information and offer only impersonalized investment-related advice.

It's important to realize that just because a trader or firm isn't registered or licensed doesn't necessarily mean they are fraudulent.

Chapter 8 Discover Your Market Personality

Do you know what your market personality is? It may sound obvious, but it's incredibly important to match the kind of investing and trading with your personality type. Many people ignore this critical principle, and lose thousands of dollars in the process of making emotional and unexpected trades and financial decisions.

The key is to find strategies that are a good fit for you, and stick with them.

Here are some questions to get you thinking before we discuss different kinds of trading and investing.

- Are you analytical, or do you tend to go with your gut?
- Do you make decisions quickly, or prefer more time to digest information?
- Are you impatient or are you a procrastinator?
- Do you get bored easily? Or do you need excitement to stay motivated?
- In stressful situations, do you tend to be more fearful, confident, angry or arrogant?

- What season of life are you in? Are you young enough that you can afford to risk more money? Can you earn back money you might lose in the market in other ways? Are you older with a family and need to be a bit more conservative with your resources?
- Are you cut out for investing or trading? This is a hard question, but nevertheless, you need to ask yourself. There's nothing wrong with answering "no" here. There are plenty of other ways to make money and plan for your retirement.
- Which markets catch your attention, stocks, options, futures, forex? Ask yourself why you gravitate towards these markets. It might be for the wrong reasons.

Choosing a market to trade solely based on the belief that you can make a lot of money is simply not smart. Each market instrument has its own unique "personality." You need to match your personality to the market you pick.

Chapter 9 Investor or Trader?

Do you know if you are an investor or trader? There are no hard-and-fast rules that delineate traders versus investors. Nevertheless, here are some general guidelines.

The Investor

Investors tend to prefer a “hands off” or passive approach to making money. They want to put their money into real estate, stocks or futures and wait for returns. Many investors like long-term strategies to pull money from the markets. There is not necessarily a defined “exit price” to an investment. Investors don’t have time or don’t want to make time to learn the nuances of the markets. Investors don’t care too much about the inner workings of a trading strategy. Some argue that investors tend to have more consistent returns over the long haul. Investing is also less stressful since investors are removed from the day-to-day operations of trading.

It’s relatively easy to get started in investing. Open a brokerage account. Find a mutual fund you like, and add your funds. Since investments tend to be long-term there are fewer commission fees.It can be easy to lose interest as an investor simply due to lack of involvement in the markets.

The Trader

Traders tend to prefer a hands-on, active approach to the markets. They think in the short term and have a defined trading strategy with clear entry and exit criteria. Their philosophy might be explained as “The buck stops with me.”

Good traders are constantly learning, and are open to improving their strategies. Traders tend to be independent thinkers, entrepreneurs and have a rebellious streak.

Traders spend hours studying the markets and adapting to an ever-changing economic landscape. Traders pay more commission fees than investors since they are actively trading.

There is a larger barrier to entry for traders than for investors. Trading can be stressful. Successful trading requires extensive market knowledge, ruthless awareness of psychological issues, fierce discipline and optimism.

Day, Swing, or Position Trading?

Here are the three most common trading timeframes. Take a look and decide which one fits your personality:

Day Trading

Otherwise known as “intraday” trading, day trading is the term used when trades are usually entered and exited within the same trading day. Day traders usually end the day flat so they have no worries about overnight news affecting any of their open trades.

Good day traders have the ability to make quick decisions. They tend to see smaller profits than longer term traders, but not always. Day traders must watch the markets all day for good trading opportunities.

Day trading requires a solid knowledge of time zone considerations which vary by each market. For example, forex trading times are quite different than U.S. stock market trading times or futures trading times.

Swing Trading

Swing trading is considered to be short to intermediate trend following. In general, trades may last from one to thirty days.Like day trading, there are time zone considerations, but swing traders aren’t glued to their trading screens every minute the market is open like day traders are. Swing traders risk overnight news that could hurtor help any of their open trade positions.

Swing trading can be done part-time, but swing traders need to be disciplined and study the markets. Otherwise, swing traders will make poor trading decisions, or lose interest in the markets altogether due to lack of trading frequency.

Position Trading

Position trading, or long-term trading, is almost like investing, but does not have quite as long of a time frame. Position trading is also referred to as trend trading. For example, when the trend shifts from sideways to up, position traders establish a position, and buy and hold until the trend comes to an end. Trades can last months or years.

Position trading is less stressful than other styles since fewer trades take place. Like swing trading, position traders are susceptible to overnight bad news.

Position trading can easily be done part-time, but requires lots of patience. There is no instant gratification like there is with day trading.

Develop Your Own Strategies

If you are interested in developing your own trading and investing strategies and systems, here are three tools that can help:

TradeStation StockFetcher Neuroshell

Chapter 10 Trading Psychology : Are You Cut Out for This?

Trading psychology is an important topic to touch on since this can play a huge part in your success or failure as an active trader or investor.

Great traders have a crystal clear understanding of their psychological weaknesses. They also have an intimate knowledge about their emotional relationship with money. Money is neither good nor bad; it simply magnifies what's inside you.

Here are a few questions you'll want to answer before you begin to trade and invest.

- Are you afraid to enter a trade after a string of losses?
- How do you handle losses?
- Do you blame yourself?
- Do you over trade just because you want something to do?
- Do you trade simply for excitement?
- Do you create drama for drama's sake?

- Do you get cocky after a string of winners?
- Do you fail to exit a trade for fear of losing those extra profitseven though your system says to exit?
- Do you have a poverty mentality?
- Do you always seem to give money back to the markets no matter how much money you make?
- Do you self-sabotage?
- Are you money-repellant?
- Are you ashamed of being wealthy?

We realize that these are not easy questions, but the issues they reveal must be dealt with in order to consistently succeed in the markets.

Many excellent books have been written on trading psychology, here are a few to consider:

- The Psychology of Trading: Tools and Techniques for Minding the Markets by Brett N. Steenbarger PhD
- Trading in the Zone by Mark Douglas
- 12 Habitudes of Highly Successful Traders by Ruth Roosevelt
- The Disciplined Trader: Developing Winning Attitudes by Mark Douglas

Chapter 11 Recency Effect

The recency effect is a fascinating phenomenon which affects all of us. The recency effect says that given a list of items, humans tend to remember the last few things more than those in the middle. We assume that items closer to us chronologically are more significant. This is short-term thinking at its worst, which is very bad for traders.

Here's how the recency effect plays out in trading. If you have a string of winning trades, you think to yourself, "I am going to win all the time no matter what I do." This leads to arrogance, breaking your own trading rules, and sloppy trading which results in flushing your money down the toilet. On the flipside, if you have a string of losing trades, you think to yourself, "I am never going to be a good trader. I will keep losing all the time. I will never recover." You become afraid to enter good trades, break your own trading rules, and take profits too early instead of letting them run. Again, your trading account suffers.

Being aware of the recency effect when you trade is half the battle. Not succumbing to it is the other half.

This is also where being aware of whether you're an investor or trader comes into play, as well as knowing your own trading psychology. If you can be self-aware enough to know that you're risk averse and don't handle losses well, then you may be more likely to give into the recency effect.

However, if you know this is happening, you're more likely to think through the situation and make the most fiscally sound decision.

For example, if you've taken a few losses buying into stock X, but it's been looking good for the last few days and the buzz surrounding X is positive, you may still shy away from investing in it. If you find yourself moving away from something that by all accounts seems like a sound fiscal investment, then try to rationalize what's happening within yourself.

If you're still not feeling confident in making the move after logically thinking it through, then maybe it's time to talk to another trader. The last thing you want to do is miss out on a good opportunity because you've been burned in the past and aren't able to make the trades yourself anymore.

Chapter 12 Keep It Simple

When it comes to understanding the markets, it's easy to get lost in the weeds and become overwhelmed. For a newcomer, it may seem like you need to decide whether to jump in with both feet, or stay out of the pool entirely.

Luckily, thanks to technology, that's not the case anymore.

Your smartphone (or tablet) provides a world of investment opportunities and knowledge with only a few taps. Here are the best ways to learn about wealth possibly that await you online:

First, before deciding to invest in any company, do some background research into it. If it's a tech company, download their app to see if they're the real deal. If the app doesn't seem quite up to par or lacking in some way, consider reaching out through their Contact page (calling is not the best way to see how the tech side of their business runs). Express your concerns as a potential investor and ask if they're already working on future fixes for these issues. Continue poking around to learn about their history, their administrative structure and any major changes, expansions or layoffs they've experienced or anticipated.

This is where the apps come into play.

For beginners, **Bloomberg** and **www.Investing.com** have apps that are perfect for you. They are free and provide a well-rounded view of what's going on in the financial world as well as provide an in-depth look at how each individual stock is doing. This way, you can keep an eye on how the areas of the market that you're interested in are performing and get ready to jump in when you feel it's the right time.

Now that you know a little bit more about the markets, it's time to get involved at an intermediate level.

If after doing your homework you think you're ready, but aren't mentally or fiscally ready to make the leap into the markets, there's an app for that. In fact, there are several.

Acorns is an app that invests an amount you have predetermined into a diversified portfolio. The amount you choose can be anywhere from a few dollars a month and up. The trick is that you can invest it at once, or you can invest your change.

You'll link your credit or debit cards, and whenever you make a purchase that isn't a solid dollar value (i.e. $1.75), the app will round it up and put those remaining $0.25 cents toward your portfolio. You can check on your investments through the app, and you can put a cap on any amount you want deposited. So, if you only want to deposit and invest $1 a month, after four purchases of $1.75, the extra $0.25 will have gone in four times, hitting your monthly cap of a dollar.

Another app that works similarly is Robinhood. While Acorns puts your money into a diversified portfolio, Robinhood lets you buy and sell stocks that you choose, giving you complete control over what you choose to buy and sell. Their big selling point: there are no commissions. Like we previously discussed, even penny stocks typically require some sort of fee associated with them, but that's not the case with Robinhood. There are no commissions paid to anyone, so in only three taps, you've bought some stocks of your choice and begun playing the markets at a level you're comfortable with.

Is this moving a little too fast? Need to back up a few dollars and do some more research? That's not a problem. How would it sound if you got $10,000 to invest in the market risk-free? Well, the deal isn't quite that sweet, but almost. The Stock Market Simulator gives you virtual money to use and invest as if you were actually investing in companies. The cash balance is filled with fictional money, but it will give you the opportunity to see what it would be like to manage your own investments and to test your tolerance for risk. By using this model, you'll be able to see how you emotionally react during market upturns and downturns, and wait to see your decisions play out. It's real world experience for the investor who is too busy to track fictitious stocks himself.

Now, it's time for the big show. If this sounds like child's play and you're ready to drop your next paycheck into some stocks, there are apps for you too. The only catch is that now the world of apps is cracked wide open, and it's up to you to decide how you want to invest. While companies like Fidelity and Merrill Lynch's Merrill Edge put the complete world of stocks in the palm of your hand, it is smart to check in with your financial institution to see what kinds of tools they have available for you.

By working with the financial professionals at an institution where you have already been doing business, you may receive some commission discounts or other perks. It never hurts to ask where you can save money when you're trying to make some.

Tips

- Don't forget to activate your push notifications on these apps so you can get an alert when there's a change with your investments or the overall market.
- Change your passwords every one to three months to help ensure your account is secure. Companies do all that they can to keep your information away from prying eyes, but anything online presents a potential risk in today's cyber climate. Changing your password is one extra step you can take to do your part.
- Don't be afraid to try something new. Just because you're investing with one app doesn't mean you can't invest with another one too.

Chapter 13 Do Your Due Diligence

Let's pretend you're going to build your dream home. You've been working and saving for years to buy the perfect plot of land, and now you're going to hire a team to construct the dwelling you've always wanted. The catch: you don't know anything about building a house. Outside of watching a few home improvement shows you've seen on HGTV, you have no clue what goes into actually making the building come to life. So, you do what anyone else would: you hire a construction crew.

This is usually where a thought-out plan can go awry. Not only can surprise costs sneak up on you, like a necessary building permit you inadvertently overlooked, but you'll also need to ensure the crew is working on a timeline that makes sense. But remember – you don't know anything about construction, so how can you make sure that timeline is a reasonable one?

The answer isn't fun, but it's necessary: you need to do your due diligence.

This scenario isn't so different from the one you will experience with your

investments- that is, if you aren't the one making all of the moves.Unless you have lots of time on your hands, chances are you've hired a financial professional to get the job done. However, it would be foolish to simply hand over your savings to someone just because they knew all the right things to say.

Do your due diligence and look into your options. The North American Securities Administration Association, or NASAA, advises:

"While the vast majority of the stockbrokers, brokerage firms, investment advisers and investment adviser firms are honest and reputable, it pays to remember that just like many other professions, there are those individuals and firms who are not.

State securities regulators should be the first call for an investor before you turn over any money to a broker or investment adviser. You can access extensive employment, disciplinary, and registration information about your stockbroker or investment adviser through your state securities regulator."

The NASAA also provides a helpful list of online resources you can use to find out if you're working with a person who will help grow your finances. Some helpful tips:

- **Working with a broker?** Ask for all materials from the Central Registration Depository (CRD) about your prospective stockbroker. This computerized database contains licensing and registration information on more than 650,000 stockbrokers.
- **Using an investment adviser?** Ask for all materials from the Investment Adviser Registration Depository (IARD). The IARD has information on more than 260,000 investment advisers.
- Search the **Investment Adviser Public Disclosure (IAPD) website** for information on investment adviser representatives and firms registered with state securities regulators and the Securities and Exchange Commission.
- Information on brokers is available from the Financial Industry Regulatory Authority's (FINRA) **BrokerCheck website**.

In addition to these steps there are a few others you can take to help ensure that you're getting the best returns and dividends possible.

One step is to use some of the educational apps mentioned in Chapter 12 to keep track of how the markets are doing. If your money isn't performing the way you'd like after a few months, make an appointment with your advisor to figure out why that is. Using our previous analogy, consider this the equivalent of dropping in on the construction site to check on how the progress is going, and determine if you think that things are up-to-par based on your own independent research or if you'll need to hire a new crew to get the job done(see Chapter Four for help on determining what is a legitimate review and what is not).

However, unlike with this analogy, it's important to remember that when it comes to finances, trust is built over years of time. That's why you should check in at least quarterly to see how your finances are being managed.

Another step you can take before investing is to go beyond the NASAA's advice and look for independent reviews of the financial planners you've spoken with. Do a Google search of their name and their firm to see what comes up. If there aren't any reviews, that's not always a bad sign and shouldn't immediately disqualify them from your search. However, if there are multiple bad reviews, this should make you think twice about working together.

It's your money and your future at stake here; don't settle for someone because you don't know any better. Learn the basics and make an educated decision about how to invest your money.

Chapter 14 Real Life Scenarios

Congratulations on making it this far! You've completed a crash course in how to avoid getting burned in the markets. Now, it's time to test what you've learned. Let's take a look at these scenarios:

Scenario 1:

It's 11:50 p.m. on November 8, 2016 and in a surprising turn of events, Donald Trump has just been elected President of the United States. After years of economic recovery, the market futures have begun to plummet and there's a small panic brewing on Wall Street.

Do you:

A. Hold

B. Sell

C. Call your financial advisor

Answer: Following the dramatic downturn, once the stock market opened, Wall Street righted the ship and the Dow had a record breaking day. If you held onto your stocks, then you made money, however if you sold them, then you gave into the panic and likely lost money. The safest decision in this case is to call your financial advisor and get his expert opinion since it's (hopefully) not his first time experiencing a situation like this.

Scenario 2:

You've been trying to invest independently, but every time you buy stock in a company, it goes down. You're not sure what you're doing wrong, but it's getting disheartening, and you're not confident in your decisions anymore. Investments work for millions of people and are a recommended strategy for retirement, but you're not so sure anymore.

A. Sell all of you stocks and start saving with cash and bonds

B. Keep investing on your own, trusting that you'll gain confidence and it will work out eventually

C. Consult a financial professional

Answer: The markets are never a sure thing, so it's possible you've had a bad run of luck. However, if that's making you second-guess whether you'll make it in the markets, then it may be time to consult a professional. The worst thing you can do is trust your cash savings to tide you over for the rest of your life. This is subject to inflation and interest rates, so it's plausible that the $500 you have saved today may only be worth $300 20 years from now.

Let a professional set you up with a low-risk portfolio so your money can grow slowly and steadily, taking the pressure off of you to invest wisely.

Scenario 3:

You're 60 years old and getting ready to hit the age of retirement. The only problem is that you haven't been preparing for it. With the news about Social Security potentially running out, you're thinking it's time to start investing. You know that the fastest way to grow money is aggressively investing in the stock market, but that's also potentially the fastest way to lose your savings if you don't know what you're doing.

Do you:

A. Keep doing what you've been doing and hope for the best

B. Take a leap of faith and start investing right away

C. Talk to a professional who has made a career out of helping people like you

Answer: While you may be inclined to take options A and B, the best choice is to sit down and talk with a financial professional. Even if you've casually studied the stock market over your morning bowl of cereal, that doesn't make you an expert in the markets. Also, at 60 years old, time is not on your side when it comes to investing, so you'll want to know about some of the most conservative, reliable, and long-term products to help maximize your investments.

Scenario 4:

You're young, starting your career and don't have much money to invest. However, you know that it's never too early to start thinking about your retirement so you want to get involved with the markets. The main problem is that you don't know how to get started.

Do you:

A. Sign up for the 401(k) plan at work

B. Start using an investing app

C. Talk to a broker

Answer: All are good strategies to start employing as you start to get more involved in the markets. Try to make contribution to your 401(k) that will maximize your employer match. If you still have money left over that you have earmarked for investments, test the waters with an app such as Robinhood or Acorns. This would also be a good time to go to your bank and ask them if they have any products for young, inexperienced investors like yourself.

Scenario 5:

You found a trading platform online and the reviews on the webpage look great. However, when you Google search it, things don't look quite as sunny. It's not that the reviews are bad, there just don't seem to be many available to view. In fact, you can't find much information about the company at all. Should you trade with them?

A. Yes, because some good reviews are better than lots of bad ones

B. No, because you don't have enough testimonials for proper judgement

C. I need to do a little more digging

Answer: If you've found an easy-to-use trading platform online that charges a fee you're comfortable with, that's great. You should be wary of a company that only has vague, positive reviews on its website. Chances are that if a company really had a lot to offer you, it would have received some press and will show up online. Do a little more digging to make sure you feel comfortable with the site before doing business with them.

Bottom Line:

Unless you're able to assume a lot of personal financial risk (and potential reward), then it's always best to talk to someone who is trained for the job. You can ask around the office to see if people have a financial advisor they trust, but don't always take their advice on when to buy and sell. Treat your money like you would anything else in your life and put it in the hands of the experts if you don't trust yourself to make the most of it.

Chapter 15 Words of Wisdom

It's no secret that Warren Buffet knowns his way around the financial business, and has a lot of wisdom to offer both the new and seasoned investor. Here are three things to remember:

1. **"I think the biggest mistake is not learning the habits of saving properly early because saving is a habit."**

Buffet said this during a 2007 address at the University of Florida, and it's important to keep in mind when playing the markets. You want to make sure you're not investing your last dollar, in case you end up losing some money. Saving enables you to invest.

2. **"Invest in as much of yourself as you can. You are your own biggest asset by far."**

It's important to remember that investments aren't only made with money, they are also made with time; your time. If you find that the return you are receiving isn't worth your time, then invest in yourself and look for other opportunities. This could mean hiring a broker or taking the time to learn on your own. The fact that you read this book is a good indicator that you're on the right track.

3. **"Risk comes from not knowing what you're doing."**

Along with investing in yourself comes the ability and desire to learn. The markets change daily, so it's important to stay up-to-date about what's going on. If you are clueless and you make a financial decision, you've created unnecessary risk. If you don't know how to do something, ask. There are thousands of people out there who make a living for themselves and others off the markets. They can help you with the tough choices.

Conclusion

Know that there is still money to be made in the markets. Take it slow. Find strategies that match your unique personality. If possible, work with a trading team, or at least one other person. They'll be able to see your blind spots when you can't. Above all, don't trade with money you can't afford to lose.

At the end of the day, it's only money. Your family, friends and your health matter most. Aim for a balanced life. If you aren't getting some enjoyment out of trading or investing, then chances are you might be in the wrong profession.

Thanks for joining us. We hope this book has helped you on your journey to success in the markets!