Copyright 1997, Robert C. Miner

Trading Philosophy, Trading Plan and Trading Rules

By Robert C. Miner, Dynamic Traders Group, Inc.

This tutorial is excerpted and condensed from *Dynamic Trading: Dynamic Concepts In Time, Price and Pattern Analysis With Trading Strategies For Traders and Investors* by Robert C. Miner due to be released in early Oct. 1997. This tutorial was Part 1 of a three part series included with the July, Aug. and Sept. issues of the monthly *Dynamic Trader Analysis Report*. Each month, a trading tutorial or special research report is included with each issue. The *Dynamic Traders Analysis Report* not only provides a comprehensive review of the position of the major financial and commodity markets, but the most complete trading education available.

Do you have a written trading plan? If not, you are probably not a successful trader. All successful businesses are driven by a specific objective which includes a plan of action; how to accomplish the objective. Most traders would say "my objective is to make a profit." A profit is the *outcome* of a well thought out and tested trading plan. The objective must be to develop a successful trading plan. The profit will be the inevitable outcome. There are really three parts to developing a trading plan; Trading Philosophy, Trading Plan and Trading Rules.

The *Trading Philosophy* is the general style and objectives of your trading business. The *Trading Philosophy* will describe just what you are trying to accomplish. The *Trading Plan* is the fundamental set of rules that guide your trading decisions. The *Trading Plan* will describe the basis of the strategies and tactics that will be the guide to the day-to-day activities. The *Trading Rules* are the specific guidelines which must be met before a trading action is initiated.

It is essential that the trading philosophy, plan and rules be well thought out and *in writing*. The business of trading is like any other business. Its success will not only be contingent on the knowledge of the individual, but how well the business is planned. It is a mistaken belief that most businesses fail in a relatively short period of time because of a lack of capital.

Copyright 1997, Robert C. Miner

The Business of Speculation Is Like All Other Businesses

Most businesses fail primarily because of a *lack of planning* and a *lack of knowledge* of the business and how to manage the business. It is no different with the business of trading. Significant capital is probably the least necessary component.

Each individual trader must develop his or her own trading philosophy, plan and rules. *You will never be successful in the long run by adopting someone else's trading philosophy, plan and rules.*

Trading Philosophy

The trading philosophy should be in a narrative form and describe:

1. The trading time frame. Is the objective to trade short, intermediate or long-term trades? What is the general time frame considered for each of these periods?
2. The general parameters of the type of activity necessary to indicate a potential trade. Are you only looking to enter on trend-reversal set-ups or breakout trend-confirmation set-ups or both?
3. The general parameters of the capital exposure that is acceptable and the profit objectives.

Trading Philosophy Examples

Below are a couple examples of trading philosophies. They represent two completely different trading objectives and will each have a different trading plan and trading rules.

Trading Philosophy Example #1

The objective is to identify the trading condition set-ups for short to intermediate term trades. Those that will last from several days to several weeks. At least two units will be taken with most trades with the objective to take profits at the short-term objective on one unit and hold the second unit to the termination of the intermediate term trend.

Trend-reversal trades will be entered when the time, price and pattern analysis factors indicate a trend reversal is probable and a

Copyright 1997, Robert C. Miner

daily reversal is made. Trend-continuation trades will be made following a trend reversal.

The capital exposure for any one position will not exceed 3% of the account balance. All trades will be held until stopped out of the market by the protective stop-loss.

This trading philosophy will form the foundation of the trading plan and trading rules for short to intermediate term trading where a trade is held until stopped out. A completely different trading philosophy might be:

Trading Philosophy Example #2

The objective is to identify the main trend and only enter short-term trades of one to three days in the direction of the main trend. A protective stop-loss is trailed very close to the market and profits are taken at short-term price objectives.

This is a completely different trading philosophy with a short-term time frame and the objective to take relatively quick profits on successful trades.

As with most businesses, you have a better chance of success if you specialize. It is unlikely you will be successful by trying to be a short-term, scalp trader as well as looking to trade the long-term trends that last several weeks to several months. The analysis techniques and trading strategies of each are much different. Almost all successful traders specialize in one type of trading.

The trading philosophy will provide the objective of what style of trading you are trying to accomplish and the general parameters of how you will accomplish the objective. The trading philosophy examples above are just that, examples. It is important for you too think about what your own trading objectives should be and for you to develop your own trading philosophy. This isn't the time to develop paralysis of analysis. Don't get hung-up on the details but take the time to simply state what you are trying to accomplish in your trading business.

Trading Plan

We move from the very general *Trading Philosophy* to the more specific *Trading Plan.* The *Trading Plan* consists of the fundamental principles that guide your trading business. The *Trading Plan* does not include specific trade-action rules.

Copyright 1997, Robert C. Miner

An example of a trading plan might include the following:

1. The first objective is to protect and preserve capital.
2. Only initiate a trend-reversal trade when at least two of the three factors of time, price and pattern signal a trend-reversal is probable and one of the four daily reversal signals is made.
3. Only initiate a trend-continuation trade when at least two of the three factors of time price and pattern have signaled a trend reversal and one of the three trend-continuation entry set-ups is made.
4. Every open trade must have an open protective stop-loss.
5. Trades are only exited by the election of a protective stop-loss, never at a specific price objective.
6. Never add to a losing position.

The first objective is to protect and preserve capital. It seems ludicrous that this rule would even have to be stated. Almost all unsuccessful traders focus on the idea of potential profits and ignore the potential for losses. Almost all successful traders are fanatical about limiting losses knowing that there is no possibility of being profitable or even staying in business over the long run if capital is not preserved.

It is often said, “take care of your losses, and your profits will take care of themselves.” There is a lot of truth to this statement. If you don’t take care of losses by limiting them, you will not have the capital to commit to the opportunities to realize profits. The specific guidelines to protect and preserve capital should be stated in the trading plan such as the maximum allowable capital exposure per trade.

An example is the initial capital exposure per trade shall never exceed 3% of the available account equity. In this case, a trade will never be entered if the stop-loss position is further from the entry position than the dollar amount equal to 3% of the available trading equity. The capital exposure rule may be a fixed dollar amount per contract such as $500. The important factor is that you have agreed upon some guideline to preserve capital by limiting losses. *Every* trading plan must include the guideline to preserve capital by limiting losses.

Only initiate a trend-reversal trade when at least two of the three factors of time, price and pattern signal a trend-reversal is probable and one of the four daily reversal signals is made. This trading plan principle

Copyright 1997, Robert C. Miner

considers the context of the analysis methodology taught in this book and recognizes that a market must meet certain technical conditions before a trend-reversal, trade-entry is considered. The trading rules will define the acceptable conditions. This trading plan principle also limits the initial trend-reversal, trade-entries to a specific reversal pattern. In other words, trades will never be taken at the coincidence of projected time and price targets, no matter how strong, without a reversal signal.

This part of the trading plan is specifically oriented to the trader buying bottoms and selling tops when the high probability conditions for a bottom or top are met. Almost every trading educator, publisher and advisor teaches to never try to buy the bottom or sell the top and only enter on an established trend. That is because they do not have the technical analysis methods to identify with a high probability the conditions when tops and bottoms are made. Dynamic Traders have this knowledge and an important part of their trading plan should be to take advantage of these unique technical analysis methods.

Only initiate a trend-continuation trade when at least two of the three factors of time, price and pattern have signaled a trend reversal and one of the three trend-continuation entry set-ups is made. This guideline is similar to the previous one except it addresses trade entries after a trend is established and limits the trend-continuation trade entries to specific trend-continuation set-ups.

Every open trade has an open protective stop-loss. If you *ever* have a trade position without an open protective stop-loss order in place with the broker, you are not a trader. You're an idiot. If there is a time in your life when you will be hit by a truck, have a heart attack or fall into a coma, it will be when you have an open position. What if the market moves relentlessly against your position as you are resisting going down that one-way tunnel toward the light? Do you want the first words you hear when you return to consciousness to be "honey, what's a margin call?"

Trades are only exited by the election of a protective stop-loss, never at a specific price objective. The trading plan must include the rule for how a position is exited. The exit rule as stated here, requires a trade to only be exited by electing a stop-loss. The specific trading rules will define the specific position of initial and trailing protective stop-losses. A different trading plan may accept profit taking objectives of a fixed dollar amount or percentage gain on the trade.

Copyright 1997, Robert C. Miner

Never add to a losing position. Adding to a losing position could be one definition of insanity. Do two wrongs make a right?

A trading plan should clearly define the basic foundation of your business of trading and the fundamental and general rules that will guide your decisions. The trading plan described above is just an example. Yours may be more comprehensive. But beware of paralysis of analysis. If your trading plan covers page after page of rules and guidelines, you've probably missed the point that the trading plan is a firm guideline to the direction you are taking and the general, inviolate rules. It is not a plan that dictates every individual action.

Planning is a three stage process that begins from the very general and works its way to the specific. The *Trading Philosophy* is a very generalized narrative of the direction and objectives of the business. The *Trading Plan* is a bit more specific and definitely provides some limited parameters on what activities will be engaged in. Step three is the *Trading Rules.* The *Trading Rules* are even more specific and provide the conditions that must be met before taking a specific trading action.

Trading Rules

The trading rules are the specific qualifications that must be met before any trade action may be taken. All rules are limiting by nature. Rules always relate to a condition. The more rules, the fewer conditions acceptable for a trade action.

A mechanical, trading system consists of specific, mathematically defined and inviolate rules. Each decision is made by the "system" without input by the user. In chapter one, I expressed my less than positive opinion of trading "systems" and the absurdity of considering any business could be successful without the application of the knowledge and judgment of the business owner. So then what do I mean by trading rules?

Trading rules as used here are the minimum qualifications that must be met before a trade action may be taken whether it is a trade entry, protective-stop placement or trade exit. In other words, a decision will only be made if a market is in a position where the probabilities for success are in favor of the decision maker. Let's consider a couple of examples of trading rules.

A initial trade entry is never taken prior to the market making at least a 50% retracement from what is suspected as the extreme high or low. In Elliott wave terms, traders would only look to buy when either the wave-2 or wave-B has made at least a 50% price retracement of wave-1 or wave-

Copyright 1997, Robert C. Miner

A. W. D. Gann taught that the "safest time to enter a market is on the first correction to the high or low." What did he mean by "safest?" He meant the time with the greatest probability of being followed by a fast and prolonged trend. In Elliott wave terms this would be the wave-3.

This rule would preclude considering buying the bottom of a bear trend or selling the top of a bull trend. This rule would force the trader to wait for at least some minor confirmation a trend has reversed and to be prepared to buy on the initial correction to the suspected new trend.

This rule does not cause a trading action to be taken, but provides the minimum qualifications for a market position before a trade may be considered.

Another rule might be - *The protective stop-loss shall never be placed further than one tick beyond the three-day high or low once a market has exceeded the 100% alternate price projection.* This simple rule recognizes that a market that exceeds the 100% alternate price projection is probably in an impulse trend that should only have relatively minor corrections until the trend is at or near completion. This is the time to trail the protective-stop relatively close to the market.

A relatively short-term trader's trading-plan may include a rule such as - *The protective stop-loss will never be further than one tick beyond the prior day's extreme once a position has reached a $700 profit.* This is a simple rule that considers the protective stop-loss should be kept close to the market position as soon as a minimum, unrealized profit is achieved. For very short-term traders, the prior day's high or low may be a long way away. Their minimum protective stop-loss rule may be much closer. Another trading rule may require a position be closed at a specific profit objective, say $500, no matter what the outlook for the main trend.

As you can see from just these three examples, a trading rule may be very specific and limiting, or it may only provide a minimum qualification before a trade action may be taken.

Your Trading Rules Must Be *Your* Trading Rules

I am not going to provide an example of a series of trading rules as I provided examples with the trading philosophy and trading plan. It is critical to *your* success that you develop your own trading rules based on the objectives of your trading plan and the technical analysis methods you employ. Developing your own, specific trading rules will require you to think carefully about your trading objectives and the technical analysis methods you are going to use. I don't want you to even be under the illusion that someone can do this for you.

Copyright 1997, Robert C. Miner

Some readers may think this is a cop-out on my part. I've presented analysis methods and trading strategies. Shouldn't I now provide you with a specific trading plan and trading rules? Don't other authors of trading books provide you with just this? Your trading business is unique. You will have goals and objectives different from other traders. But, there is one factor that is common to all *successful* traders.

All successful traders have created their own trading plans and trading rules. They know ***success cannot be bought***. All successful traders have taken the time to develop their own trading plans and rules that guide their business of trading. The Dynamic Trading analysis techniques and trading strategies taught in this book provide you with a comprehensive framework of understanding market activity and the position of the market at any time. The trading strategies taught have provided you with simple low-risk and low-capital exposure trade set-ups.

The *Dynamic Trader Trading Course* that is included with the *Dynamic Trader Software* includes a complete section on trading strategies, trading plans and trade management. If you have not received our 32-page booklet fully describing this unique trading software and course, e-mail our office with your postal address and we will sent it to your immediately.

Dynamic Traders Group, Inc.
6336 N. Oracle Suite 326-346
Tucson, AZ. 85704
(V) 520-797-3668
(Fax) 520-797-2045
(E-mail) dt@dynamictraders.com
(Web) www.dynamictraders.com