Creating a Trading Plan **Bradley W. Gareiss**

A trading plan is a must. I would be will to bet that virtually all successful traders have one. However, most new traders have no plan. In fact, I bet most new traders barely even have actual reasons for entering a trade. Imagine that you are planning to loan money to a new business as an investment. Could you picture yourself lending money to this person if they had no business plan and said they were going to start their business based on "their gut"? Of course a person would never be able to start a business by relying only on their gut. However, plenty of new traders start trading in exactly that manner.

Creating a trading plan is actually relatively easy. There are several core requirements that make up the plan. In my opinion, the main components of a trading plan are:

- Trading objective (goals). What and when to trade.
- Money management.
- The edge (trading strategy that puts the probabilities in your favor or a long sequence of trades).
- Documentation and analysis of the results.

First, we have to define our trading objectives. Why are you trading? What is your end goal? Most new traders have completely unrealistic goals. For instance, a new trader might want their $10,000 investment turn into $100,000 in their first year. While this is possible, it is highly improbable. These unrealistic expectations kill off a lot of traders before they ever had a chance. I think breaking even in the first year is an admirable goal; many traders do not do that. If a trader makes 20-30% on their initial investment in their first year, that is outstanding.

Next, we have to determine the basic outline of how to get there. What currency pairs (or other financial instruments) will you trade? This sounds simple, but it is easy to get off track by not defining this. I am in favor of utilizing as many pairs as you can comfortably manage, but I would not waste time with illiquid, choppy pairs. Other traders love choppy pairs. It's up to you. You also have to determine when you will trade and how often you will trade. Are you going to be a day trader or hold positions for a longer period of time? Your schedule and responsibilities may have some impact on that. But it is important to define these basic ideas to begin to form some consistency.

Money management is probably the most important aspect of trading. Would you rather have a fund manager who was a great analyst, but used poor money management? Or would you rather have a manager who was an average analyst, but used perfect money management? I think the answer is obvious. Even the best analyst will eventually blow out their account if they don't manage their risk properly. First, you need to determine how much risk capital you have to fund you account. Then you must determine how much you will risk on each trade. Most traders risk 1-3% of their account balance on each trade. This may sound low to the inexperienced, but after you blow out your account while risking too much, you will see why 1-3% is appropriate. It is also important to determine what your minimum risk to reward ratio will be. This could vary based on your overall trading strategy. Then calculate what your break-even winning percentage is. For instance, if your minimum risk to reward ratio is 1:2, you must win one out of three trades to break even.

Along with money management, it is vital to have an "edge". An edge puts the probabilities in your favor and allows you win more than you lose in the long run. Without an edge that makes you money over time, proper money management will only delay the inevitable as your account dwindles. There are many different methods to acquire this edge, but it is important to find one that is compatible with you. Also, back-testing may offer some help in determining an edge, but I think its value is overvalued. I think the true test of an edge is actually using it for future to trades, which will expose flaws in your execution of the strategy that back-testing won't.

The final step is to keep track of your results. I typically have a spreadsheet that has the following fields at the top of the page:

- Date Symbol (e.g. - EUR/USD)
- Action (buy or sell)
- Lots (how many lots were bought/sold)
- Risk (in dollars) Profit potential (in dollars; you need one column for each profit target you have in your strategy)
- Result (profit/loss in dollars)
- Equity (account balance after the trade has closed) Notes (to keep track of anything I want to remember about this trade)

This format makes tracking results very simple. Please notice I track everything in dollars because that is true unit of measure, not pips. This format also makes it very easy to plot your account equity curve on a chart. There are tons of statistics we can draw from this information that would take too long to write on this feature. However, the biggest perk of tracking your trades is that you look at the big picture. If you don't write down this information, you will weigh the past 3 trades very heavily and maybe be able to remember the past 10 trade results (but I doubt it). This spreadsheet will allow you to identify problems with your overall plan and trading strategy so you can fix them.

This is a pretty basic start to having a trading plan. Experienced traders know that many more details are eventually inserted into this template to prevent mistakes and encourage good habits. However, I feel the above is the bare minimum required to developing a viable trading plan.

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