Twitter Thread by TraderLion ■

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8 Steps to building a Trading System (Thread)

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Individuals must keep their personality, lifestyle, and risk appetite at the forefront of their minds when building their trading system.

In this thread we will break down the components of a successful trading system for consistent returns in the markets ■

Components of a Successful Trading System

1. Market
2. Time Frame
3. Edges
4. Entry Tactics

5. Setups
6. Rules & Risk Management
7. Journaling
8. Post Trade Analysis

Let's discuss the first component, The Market.

The financial markets are divided into the following ■

1. Equity
2. Bond
3. Futures
4. Forex
5. Commodity

Each market requires a different set of knowledge, skill, experience, and know-how.

Once you know which type of Market you want to trade, you must now choose your Time Frame.

Day Trade
Swing Trade
Position Trade
Combination of all the above

Time Frame often aligns with a traders personality, lifestyle, goals. ■

Day Traders ■

Often times day traders use a lower time frame to buy/sell in their respective market. This usually corresponds with an intraday chart (1 minute, 5 minute, 15 minute, etc) all the way up to a daily chart.

The appeal of day trading is that by executing all of your trades during the session, you remove any overnight risk.

You may miss out on bigger moves, but it may be easier to sleep at night knowing you have no money at risk.

Swing Traders ■

Swing traders will primarily focus on the daily/weekly charts, accepting the overnight risk & play for a bigger move over the span of a couple days to a couple of weeks.

Executions usually occur on a lower time frame with the longer term trend in mind.

Position Traders ■

Position Traders are also using the daily/weekly timeframes, but add in the monthly as well.

These traders are looking to hold on to their positions for multiple weeks to months.

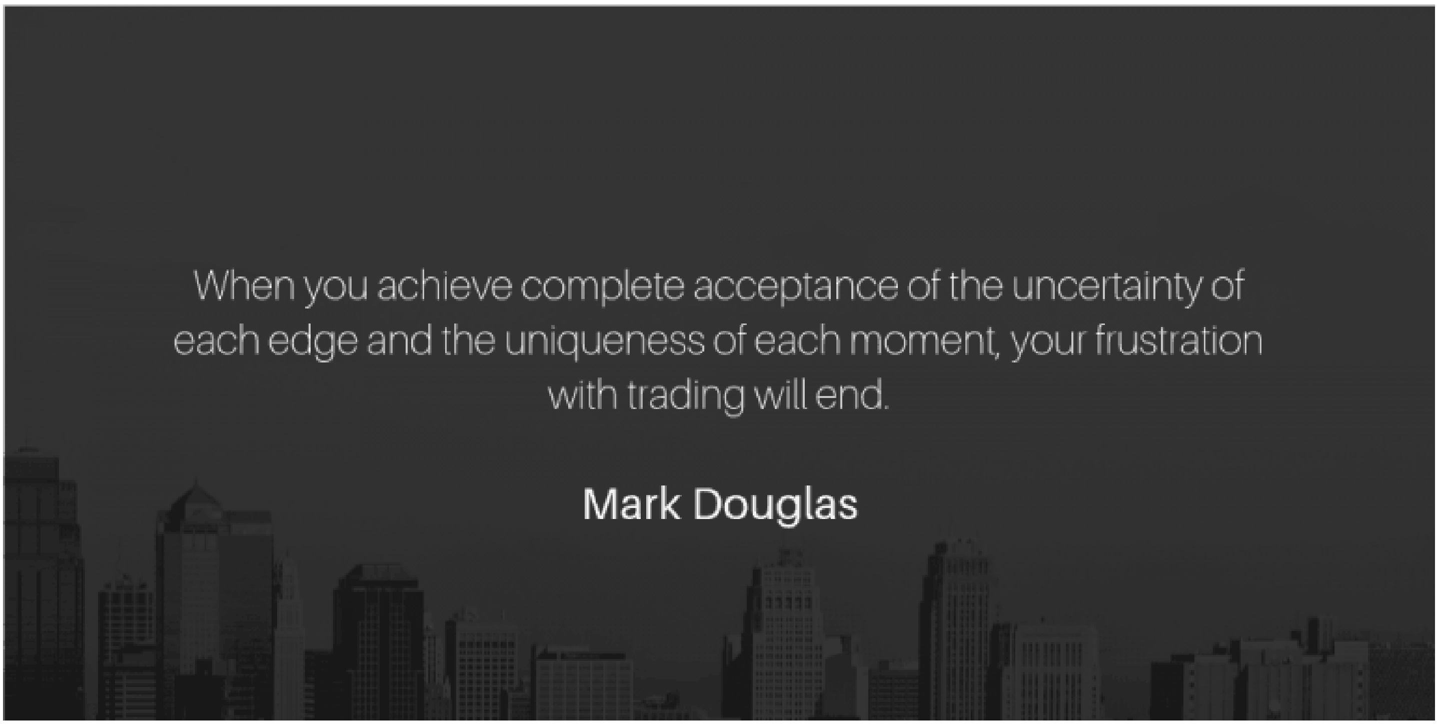
Combination of the 3

When identifying your style in the markets, it is normal to try out different time frames & see what works best for your personality.

The only thing that matters in the market is extracting an income over a large sample size, how you do it is up to you.

We can extract income from the markets over a large sample size only if we are acting using the next requirement in a trading system: Edge.

According to Mark Douglas, "An edge is nothing more than an indication of a higher probability of one thing happening over another."



So, how do we get an Edge in the market?

This comes from repetitive study of patterns seen in the biggest winners from the market and the timeframe that you are trading.

You have to understand the common themes that each winner displayed before they run up in price.

An example of an Edge in the equity markets is CANSLIM, a system created by William O'Neil.

WON was able to create and build CANSLIM by looking at the Fundamentals & Technicals of the strongest winning stocks of his time, building a set of concrete rules to catch these moves.

If you want to learn more about CANSLIM, take a look at our thread here ■https://t.co/wm5dux912o

> An Introduction to CANSLIM (Thread)
>
> — TraderLion \U0001f981 (@TraderLion_) June 5, 2021

Once we have an edge, we then identify a Setup. with that edge.

To do this, we need to have defined criteria that allows us to manage our risk so that if the trade goes against us, we don't lose all of our capital.

Managing risk is the most important part of a Setup.

Risk Management

This is the most important part of any system in any market. Without proper risk management, you are susceptible to unnecessary drawdowns leading to emotional swings.

What does proper risk management look like?

There are many different ways to approach this area of a system, but the most simplistic form of defining your risk parameters looks like this:

- Rules
- Proper position sizing
- Risk/reward ratio

Rules

Rules act as guardrails to make sure your behaviors in the market are contained and repeatable.

Trading is an emotional game. Rules help prevent you from damaging yourself when things may feel out of control.

Examples of rules:

3 losses in a row = a multi-day break.

During a Market Downtrend (below 21ema) = look for shorts more than longs

Taking x amount of days off per year to BUILD mental capital.

No big losses = having a MAX, non-negotiable stop loss for every single trade.

When creating your rule set, you want to make sure it is not too restrictive. We want to be able to operate in a flow state & having too many rules may prevent this from happening

Proper Position Sizing

We want to make sure our exposure is large enough to make significant progress in our overall account but also small enough to keep losses in control when we are stopped out

Traders are wrong more than they are right, so position sizing correctly is key.

There are many ways to determine your position sizing, but a simple one to make sure you don't lose all of your account in one trade is to risk 0.5-1% of your equity per trade as a MAX stop loss.

You would have to lose on 10-20 trades in a row to lose 10% of your account.

A 10% drawdown sounds scary, but it is important to note that we still live to fight another day with this method.

On e of the major key to super-performance is to never let your account value fall too far from all time highs

Risk Reward Ratio

You always want to make sure your gains are at least 2-3x your losses. If you are risking $100 on a loser, you want to be making $200-300 on your winners.

Following these parameters means you can be right only 1/3 times and still not lose money.

It is also important to learn when to both ramp up or scale back your exposure in response to the current market environment.

This skill comes with experience but is an important part to super performance.

Journaling

When trading any market, it is essential for you to understand how your emotions impact your overall trading

To accurately track this and learn from your emotions, you need to write down what is going on in your brain during the trading session.

Some easy things to keep track of are:

- Feelings premarket
- Intraday executions, with reasoning and edge defined
- Emotional swings during the day
- Grading your trading execution post market.

By continuing to build a database of these points, you will be able to connect your current state in the market to past states. This will allow you to perform better over time as your brain builds pathways, leading to better execution and decision making.

The last part of any successful trading system is Post Trade Analysis.

PTA helps you see what is working vs. what is not working.

It acts as a report card.

This is when we need to be the most honest with ourselves in our trading.

Think about how athletes study their best and worst games. This allows them to identify tweaks and improvements that need to be made

In may be painful to go through past losses but sometimes looking back on your past trades is the only way to catch flaws in your decision making.

How to do PTA:

- Tracking win rate on a per edge basis (is your edge working more than others)
- Avg gain/loss
- Batting average
- How you handle losing streaks (do they get worse, do you stop trading, etc.)

The outcome of PTA should be an improved system overall.

Regardless of your strategy or timeframe your system must incorporate the 8 components we have described above.

What component do you think is the most important?

Let us know your thoughts below ■

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https://t.co/C7fXaDuNmF

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> — TraderLion \U0001f981 (@TraderLion_) February 19, 2022