My dog ate my forex.

The 3 reasons why nearly every forex trader loses money—and what you can do about it!

By Doug Breiten

Risk Disclosure

Trading foreign exchange on margin carries a high level of risk, and may not be suitable for all investors. The high degree of leverage can work against you as well as for you. Before deciding to trade foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. The possibility exists that you could sustain a loss of some or all of your initial investment and therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with foreign exchange trading, and seek advice from an independent financial advisor if you have any doubts.

Introduction

As I sit down to write this short book, I reflect upon 15 years of fascination with the markets. The last 10 have been studying the Foreign Currency (forex) market. The allure of making boat loads of money trading still grips me. Tales of hedge fund managers making hundreds of millions if not billions per year with gains of 500 to 1000% are hard to resist. The harsh reality is that most of us traders lose our entire accounts many times. Very few of us ever understand why we continue to lose. Nor do we discover how to profit by changing our behavior just a little bit. If you've had the experience of losing all or most of your account trading forex, you're in good company. The bad news is that it is our own fault we lose money trading. On numerous forums, I've read of traders complaining that their broker was hunting stops and somehow or another cheating them out of their money. They are correct about one thing—the broker is taking our money! But, we are giving it to them. They do not have to cheat us out of it. **Your dog (broker) certainly did not eat your trading account—you fed it to them!** The good news is that there are some simple steps you can take that can help turn your failures into success!

I have discovered 3 simple secrets to trading successfully. You have undoubtedly heard some of these before. But what is different is the one final secret that ties it all together for the lone trader. This one component was what I was lacking to maintain success in my own trading.

After I developed a trading strategy that was consistently profitable, I started GroupofTraders.com (GOT) to help me take advantage of secret #3. Although I started GOT to help me with my own trading, it has become a Win-Win situation. By helping other traders be successful, I in turn become a more successful trader. The reason for this is one of the secrets shared in this book.

Of course, there are no guarantees of success, either in life or forex trading. None-the-less, my approach to forex trading is to have a statistically sound trading strategy that has a proven track record of performing over the long run. I follow the strategy strictly because I know the statistics are on my side. **Experience tells me, that if I don't strictly follow my system (i.e. I gamble), I am 100% guaranteed to lose money.** If you do not gain anything else from this book, please take the previous sentence to heart.

In the pages that follow, I will layout the 3 secrets that can help make you a winning trader. Also, as I reveal my story, I have highlighted some lessons learned. My hope is that if you are new to trading forex, you will avoid these mistakes, save a lot of your hard earned money and use it to earn the life you deserve. If you are an experienced trader, I hope you are already profitable. If not, stop trading, read the rest of this book and visit GroupofTraders.com to find out what you need to do to get on track.

Introduction

I first became interested in trading commodities somewhere around 1996. I received a junk mail advertisement for a commodities trading course developed by a "supposedly" well known and successful guru. His sales copy was very convincing. I bought his course on technical trading and studied it intently. It was not easy to trade then. At that time, most markets were not tradable via internet yet. Everything happened by phone. I also had to buy paper charts from a charting service (much like a newspaper subscription). Each day I had to manually update the bars on the chart until a weekly updated copy arrived in the mail. I am not sure why, but as difficult as it was to actually enter trades back then, I was hooked.

It became obvious early on though that trading was not as easy as the expert made it appear. His methods worked great in the course books because he had cherry picked examples of when everything went well. Often times though, the methods failed. Nothing was taught about money management or trader psychology. I was not prepared for handling the inevitable times that the methods would not work. Being young and naive, I believed that his course was all I needed to be successful. I look back and see that he might not have been as successful at trading as he claimed to be. I remember one instance in his book where he talked about getting started by driving around selling his trading courses out of the trunk of his car. I never thought to question why he needed to sell these courses out of his car if he was such a great trader! We see this kind of thing every day. No money down real estate experts and get rich quick trading systems. For most of these guys, the real money is in hawking this stuff to newbie's. Nothing has changed in the last 15 years; in fact, the problem has gotten worse due to the ease of email and internet marketing.

Lesson #1: If an expert is unwilling to share verifiable proof of his/her expertise, buyer beware!

As I mentioned earlier, I was none-the-less hooked on the concept of trading. By 2001, I had stumbled across currency trading. I continued to study the forex markets, test my own theories and occasionally buy books by other gurus on the subject. The end result was always the same- *limited success and eventual total loss of my trading account funds*.

Lesson #2: Forex brokers love newbie traders. They are almost guaranteed you will lose all of your money to them.

Any trading methods or systems that I tried would work for a time and then fail miserably during other times. I think this is how many gurus get their start. Out of desperation and frustration, they turn to marketing what they themselves cannot make work over the long term. They demonstrate that something works by pointing to a few examples of success and collect money for giving their advice. Then they are gone before their customers figure out that the system doesn't really work over the long run.

I struggled for years trading both demo and real accounts. At one point, I had taken a real account, turned a 700% profit in about a month (by dangerously over-leveraging) and proceeded to lose the entire balance the next month (using the same *awesome* over-leveraging technique). This type of thing frequently happens to gamblers. In fact, several forex brokers hold forex trading contests for this very reason. They do this to entice new traders to sign-up for real accounts or to deposit additional funds to their existing accounts (remember lesson #2). The top prizes can be huge. I've seen upwards of $25,000 (funded to the winner's trading account of course). I've watched contests with interest in hopes of trading just like the winners. At the end of the contest there is always some idiot that manages to make 500 to 1000% return for the month. Oddly enough, they are usually never heard from again. I am not suggesting that the winners are not a real people with a legitimately awesome month of trading. I did it once myself. My point is that these winners most likely lose just as often—**and lose just as big!** If they were really that good, they would be Supreme Ruler of the World in short order. Bill Gates and Warren Buffet would be working as his/her driver and butler. Do the math of compounding returns!

Lesson #3a: See lesson #2.

Lesson #3b: Yes, some traders really do make a +1000% returns in a single month. Unfortunately, it was probably through dangerous risk and luck.

The trading contests are a marketing tool used by the big brokers to entice newbie traders to hurry up and loose more money to them. This encourages gambling; and gamblers **NEVER** win long term trading forex.

So now that I have covered some of my early trading experience; I am sure that you probably recognize some of these mistakes in your own trading. Well, don't throw away anymore of your account balance repeating these same mistakes over and over again as I did.

The next section will lay out the 3 secrets that I discovered to finally trade consistently and successfully.

SECRET #1

Secret #1: Have a trading system (that works).

This probably doesn't qualify in and of itself as a secret. You would think that having a trading system would be common sense. Well the truth is that most traders lose money and nearly all of them think they have a trading system in place. I certainly did. So what is the reason most traders are losing money? Besides the possibility of not having any system at all, there are three possibilities:

1) Their system doesn't work long term.
2) Their system works and they aren't following it.
3) Their system does not manage the inevitable downside risk.

I would bet that most traders are guilty of all of these. I spent years reading about, devising and testing trading strategies. Numerous times I thought I had found the holy grail of strategies, immediately started trading and quickly started losing money.

The problem with the majority of trade systems is that they work for a period of time, often making terrific gains. Suddenly, market behavior changes and the system completely breaks down, giving back all gains and then some. It's a one step forward and two steps back scenario.

A good example is with most "pip scalping" systems. Pip scalping is the act of quickly entering trades for a very small profit and then quickly getting back out. This may work fine for awhile until you eventually take a position at a peak, the price plummets and you almost instantly lose all the gains in one trade that it may have taken ten successful trades to get. If you are going to trade in this manner you are probably a gambler. If you want the thrill of constant trading action—go to the casino. At least the casino will give you free drinks while you are losing your money! Now, this is not to say that there aren't any scalping systems that work. They are not my specialty and I don't trade them currently.

> Lesson #4: If you trade frequently and love the thrill of it, you may actually be addicted to gambling. Profitable forex trading is not and cannot be a daily thrill ride. It is the means to an end. Gamblers will never profit in Forex long term—NEVER!

If you are fortunate enough to recognize that you have been gambling instead of trading, then you have taken a critical step toward becoming profitable.

I certainly cannot cover every possible trade system here and what may or may not be good about them. The possibilities are endless. I can only speak to my experience and the trade system that I have ultimately settled upon using.

Finally, I personally want to limit my time spent trading. There are very good reasons to do so. A trader that spends all of his/her time looking at the market does not have a strategy they trust. I used to glance at the market every 15 minutes or so, especially when I had money in a trade. I tended to "over trade" by giving in to greed or boredom and entering a trade for no reason other than I "thought" I knew what the market should do. Other times, I would worry that a winning trade would turn around soon and I would exit too early. Even worse, I would second guess my Stop-Loss, exit the trade and then watch as the market took off without me.

The most inconvenient system I traded was based on the first hour of the London session. Since I live in mid-western United States, the London session starts at 3am here. For months I was setting my alarm and getting up every morning at 3am to see if I could setup a trade. This drove my wife nuts. She was annoyed to be awoken by me getting up at that hour—especially for something that never showed signs of being profitable! I no longer have a trade system that requires full time attention nor inconvenient hours. At times there has been a small trade-off in not getting in a trade at a better price—but it has been worth it not to stress full time about trading. My performance has also increased because I am not tempted to overtrade. I can't tell you how many traders I see on currensee.com that have hundreds of trades per month and are still posting negative returns. Many of these traders are attempting scalping and it isn't working for them. It is difficult, but you have to get over the mindset that you have to trade as if it is a full time job. Quantity does not equal quality in forex.

Lesson #5: Frequent trading does not make you a better trader. Better trades make you a better trader.

One more thing about quantity: Don't quantify your trading system in terms of pips. Everybody wants to say they have a goal of "x number of pips per day/week/month". It would be wonderful if we could rely on how much we can make per day or month of trading. This is what I call "Joe paycheck" mentality. The average "Joe" wants to go to work and get a reliable paycheck. This is especially true for Joe Trader that is eager to "make a living" trading forex. The problem that Joe Trader has is that if his trading is falling short of his "paycheck" goal for the month--what does he do? He starts trading more and trading recklessly! Which I guarantee is going to get him the opposite of what he is looking for.

Lesson #6: Don't quantify your trading system in terms of PIPs per day or month.

The currency market has cycles and does not behave consistently. Therefore, a goal based on number of pips per period doesn't make any sense. If the market doesn't present any opportunities to trade based on the rules of your system, then do not trade. The market doesn't care what your goals are. It does what it's going to do. My system is consistently profitable, but the amount of the profit is not consistent. Therefore, it does not do me any good to predict how much I am going to make from one year to the next. Some years the results are 40% and some are over 200%. That is quite a range, but even the low end is phenomenal compared to the stock market and I am grateful for it. It is also far better than the losses that 95% of traders are getting. You can't force a certain amount profit from the market, or any profit for that matter. Be happy for what it gives you.

Instead of a pip quantity goal, I recommend a profit/loss ratio goal. Again, you need to know the back test history of your system. Currently, my system averages 4.6 ($4.60 profit for every $1.00 lost in a year). My worst year tested is 2003 with a ratio of 1.87. Very close to the commonly touted 2:1 risk reward ratio. You can calculate this once you have back test data compiled for your system.

Total your back tested pip profit together and then the pip loses together for each year. Now divide the profit total by the loss total. You now have the profit/loss ratio for that year.

Do the same for the other years and then average the ratio results together: Add the ratios for each year together and then divide by the number of years.

I would recommend that you at least have an average of 2 to 1 profit to loss. Higher would be better. Remember, initially we base our calculations on back test data. Back test results are theoretical and are not the same as real time trading results. They are a necessary first step to knowing whether or not your potential trading system has a chance of being profitable during real trading.

You can however, check out www.GroupofTraders.com/membership for information on how you can follow along with me while I trade my system.

My system meets these 3 requirements:

1. Must back test profitable for 5 consecutive years.
2. Must not have shown a worst case loss “Draw Down” of more than 25% at any time.
3. Must not require full time trading to implement.

As I have stated before, many systems stop working for periods of time, taking back hard earned profit. A system is of no value if it has long term cyclical results.

SECRET #2

Secret #2: Money and Risk Management

Secret #2 is not a big secret to successful traders. There are numerous articles and discussions on the internet, forums and blogs about money and risk management. It is practiced by any serious investor, no matter if it is in real estate, stocks, commodities, forex etc…. However, it is amazing how few individual traders understand or practice it. They will repeatedly over-leverage or not use a Stop-Loss on their trades.

I can tell you that I have made this mistake numerous times. At first, it was my stupidity. I lost because I did not how much leverage I could afford to risk. I also did not limit my risk with a Stop-Loss if my trade went really wrong. A Stop-Loss is the price at which you exit a trade that is moving against you. Neglecting both of these tools will quickly wipe out your trading account. Usually a trader's greed or fear overrules common sense. Greed will cause you to maximize your leverage so that you can make a killing on a small price movement. Fear will keep you from using a Stop-Loss because you are afraid that the Stop-Loss will actually work. You fear that as soon as the Stop is hit, the market will turn around.

Here's how a newbie trader trades:

1. You make risky over-leveraged trades, and you make money the first few times. Then it becomes standard practice. A BAD HABIT HAS FORMED!

2. You start to lose and avoid getting out of losing trades, because "you know the market will come back in your favor". You neglect to use a Stop because that will guarantee a loss.

3. If you're not already leveraged to the maximum allowed in your account, you add more trades so that you can make up the loss more quickly. You reason that the market has to turn around any time now.

4. Your account goes to margin call and the broker liquidates your positions. Your account is worth near zero.

Lesson #5: Doing the wrong thing and getting the right result can cost you a lot of money in the long run. I hope you are fortunate enough to lose right away when you over leverage so that you learn your lesson much sooner than I did.

Lesson #6: Greed is the absolute enemy of successful trading. No one is without Greed, neither you nor me. Keep it in check and you are on your way to trading profitably.

The Stop you set will vary depending on your trading system. It should be independent from your account size, since your account size dictates the leverage and/or lot size that can be traded. From back testing, I can identify an optimized Stop-Loss that gives the highest return over time. It is an iterative process that might not be fun and exciting, but it is extremely important! You have to treat Forex trading like a business, and you have to have this information to make good business decisions.

Lesson #7: You have to treat Forex trading like a business

How do you calculate Stop-Loss and Lot size?

Unfortunately, I cannot tell you what your Stop-Loss should be for your trading system. You will have to do your homework and back test to get this information. If you need guidance with this, GroupofTraders.com Premium Members have access to my training on these topics.

However, I can show you how to calculate the number of lots you can trade if you want to limit your risk. This is something that you need to do right away if you are not already.

The example on the next page will help you calculate the lot size you can trade. It assumes that you already have a Stop Loss identified for your trading system and you have identified what your downside risk should be.

EXAMPLE (Lot Size Calculation)

Calculate the lot size for the EUR/USD pair with an account balance of $1000 (or Euro, Yen, etc…) and a maximum Draw Down risk of 25%:

Our broker uses the following scale:

0.01 lots = 1,000 units of base currency—micro lots
0.10 lots = 10,000 units of base currency—mini lots
1.00 lots – 100,000 units of base currency—standard lots

You first need to calculate your maximum expected pip loss from back testing:

Assuming that you did your back testing homework, you know that your system has, on occasion, lost 4 trades in a row with a 50 pip Stop-Loss. *

You would then calculate your worst case loss based on losing 4 X 50 = 200 pips (or .0200).

Since the account balance is only $1000, we will be trading micro lots. Our broker uses the scale of .01 lots = 1000 units of currency. For EUR/USD, 1 pip = .0001. The profit or loss on each pip of price movement is .0001 pips * 1000 units = $0.10 for the EUR/USD pair.

25% of our account balance is $1000 X 25% = $250

The monetary equivalent of our 200 pip max loss is 200 X $0.10 = $20

Since 25% of our account is $250, we get the number of micro lots we can trade by $250/$20 = 12.5 micro lots or **12,500 units of currency**.

If we are trading on the MetaTrader platform, we would enter .12 in the volume box. I rounded down because some brokers do not allow trading a half lot. I mention the MetaTrader platform because nearly all major forex brokers use it. So it has become somewhat of an industry standard trading platform.

*Remember, this is an example only! It is based on a hypothetical trading system. Do not

Notice that in the hypothetical example that I did not use 25% of my account balance as a Stop-Loss for one trade. That would be much too high of risk for one trade. The example above using 12.5 lots, has a risk per trade of 6.2% (25%/4 trades). Many good traders would consider 6% too high as well. It really depends on how comfortable you are with your trade system and its historical performance. The 25% used here is a hypothetical worst case scenario. If 4 trades go bad in a row, you lose 25% of your account balance. Your situation or trade system may dictate that you use a lower risk number than 25%. The reason I used 25% in my example instead of 6% is that I look at my system risk in terms of multiple trades. In this example I am calculating my lot size based on the historical occurrences of 4 losing trades in a row. Again, there is no guarantee that I won't lose 5 or more trades in a row in the future. I certainly hope that doesn't happen; but, based on my back testing in this example, it is a likely occurrence. You should use whatever numbers match your situation the best.

Proper money and risk management is the key to surviving the inevitable times when a system will not work. There is no such thing as a system that profits 100% of the time. My system would fail if I did not limit risk. It is easier to limit risk if a trading system has not historically shown long periods of loss (also known as drawdown). I like to see historical drawdown not exceed 25% of my account balance. That sounds like a lot, but considering what happened in the stock market in 2008 it seems reasonable by comparison. A system with good historical profitability should recover quickly. But remember, there are no guarantees, just statistics. A trader has to have faith (not blind faith) in their trading system.

This concludes my coverage of the first two secrets. They really are tangible secrets; ones that you physically need to do to help you succeed trading. In the next section we are going to look at the third secret. Secret #3 is not obvious or tangible, but I believe it is very critical to making it all work.

SECRET #3

The problem with these first two secrets is that most traders fail to follow through with them. Even I still have the temptation not to follow my trade system sometimes. I still get tempted to trade because the market looks like it is going to continue a strong move in one direction or another. A little voice says to be greedy, enter to take a quick profit—even though experience tells me that that kind of trading fails more often than it is successful.

Lesson #8: We can't trust ourselves to always follow our trading rules.

This is exactly the reason the majority of traders fail. The sad truth is that we cannot trust ourselves, unless-----------------**SOMEONE ELSE IS WATCHING AND THEY KEEP US ACCOUTABLE!**

Secret #3: Trade as a group.

I am much more likely to stick with the rules if I know someone is watching. I believe most people are this way too. This is true for life in general. Most ordinary people that start diets or exercise routines usually quit if they do not have a partner to keep them motivated. We all know that we are most likely to follow rules if we think or know that someone is watching what we are doing.

This was my original goal when starting GroupofTraders. I knew my system worked very well; but to insure that I followed my systems rules, I needed people to be watching. I needed to have members that I could help and in return, they would be helping me by watching what I am doing in real time.

Fortunately, a social networking site for forex traders called currensee.com, made it easy to share my real trading account results. Currensee is a third party that monitors their member's account(s) via an add-on for the MetaTrader platform. I highly recommend any trader to become a member. It is free to join and you can research and "friend" other traders, see their trade results and participate in forums to ask questions. To become a member, you do have to have a real trading account with a broker that is compatible with their system. Click here for more information on joining: http://www.currensee.com

4 STEPS

If you are new to forex trading, please take the lessons and secrets into practice and avoid the losses that befall all new traders. If you're a veteran trader and you haven't been trading profitably, hopefully you have gained some insight as to why you may have not been profitable. Change your habits and you will probably change your trading for the better!

However, this is not the end of your journey to profitable forex trading. Knowing the 3 secrets is only the beginning. I have put together the following 4 step process to carry you forward:

STEP 1

Open a Demo trading account with a broker. A Demo account is a free virtual account that you can trade as you would a real account without risking your own money. I would recommend that you use a broker that uses the MetaTrader platform and is compatible with Currensee.com so that you could later become a member (its Free). http://www.currensee.com

Ideally you should also open a REAL micro-trading account that is Currensee compatible. Some brokers allow you to do this for as low as $50. Currensee requires that you link a REAL account to your membership. They do this to ensure the integrity of the community. **WARNING: If you do open a REAL account, please do not trade in it until you have first DEMO traded profitably for at least (3) months!** If you cannot profit on a demo account, you will certainly not on a real account. Also, trading a real account is different psychologically than that on a demo. There is no guarantee that you will make money on a real account. You will face all the psychological challenges that I have covered in this book. Fortunately, you know the 3 secrets that will help you avoid the mistakes most traders make.

STEP 2

Continue your trading education by signing up for a FREE membership to GroupofTraders.com. You will get newsletters with insights and trading ideas, as well as encouragement in your trading activities. Most importantly, you will have a benchmark by which to measure your own trading.

Premium Members get notifications when I see a potential trade opportunity and when I am opening a trade. You'll know when I actually place, edit or exit a trade—all the specifics. You also get access to advanced topics on how to analyze your own trade systems.

Step 3

Get a simple trade strategy and Demo trade it for (3) months. Keep a log of your trades and note any deviations you made from the system. This is important! When you give in to the temptation of not following your system, you will see a pattern of losing trades that probably should not be there. This is an important exercise for you. No amount of me telling you to strictly follow your system will get you to do it. You have to see how much harm it is doing via a written log. Repeat step 3 until you no longer deviate from your system. If you want to experiment with other trading methods, do those in a separate demo account. This way you always have a benchmark account from which to compare all others.

Step 4

Repeat in a REAL account what you were doing successfully for the past 3 months while DEMO trading.

If at any time your trading system seems to stop working, quit trading immediately and demo trade until you are confident in your system or determine that you need to try a different approach. **Never wait until your account balance goes to zero!**

Conclusion

I hope you have found this book enlightening and it has found you before you have lost any money. It is really up to you at this point. You have to put these lessons and steps into practice. Forex can be extremely rewarding. But; as with most things, to be successful takes some effort. It is possible to consistently profit in forex, but you must treat it like a business—not like a casino game. Don't let your "dog" eat your forex account!

If you are reading this, you probably already have signed up for a free membership to GroupOfTraders.com. If not, please do so. I am constantly researching new ways to trade and evaluating products. I will pass along new discoveries and insights to forex trading as well as reinforce the principles learned in this book. I look forward to helping you along in your forex journey and profiting together.

-Doug Breiten