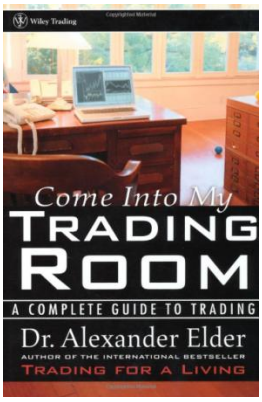
Come Into My Trading Room

A Complete Guide to Trading

by Dr. Alexander Elder



Book Review and Recommendation

Come Into My Trading Room is a worthwhile book, with substantial wisdom especially for beginner traders (say 0-2 years' experience), but with useful reminders and some new ideas for more experienced traders.

The book is divided into three sections: the first is an introduction to intelligent trading for beginning traders; the second section (which makes up the bulk of the book, about 65%) covers psychology, technical analysis, trading plans, money management, and some trade set ups; and the third section provides suggested record keeping guidelines and six example trades from Dr. Elder's trading diary.

The book is well written and concise, and for me is a rare example of a 'complete' trading book that touches on theory, set-ups, entries, exits, record keeping, psychology, money management, and general advice, but with plenty of humility and no outlandish promises. It is all there and easy to read and comprehend. Some experienced traders may find parts too basic (e.g. section one, or the coverage of money management and trading plans), but there are also a lot of higher level concepts like stop placement, how to define and calculate market noise, and tactics for swing versus trend trading which more experience traders will benefit from.

I particularly enjoyed the tactics for dealing with contradictory signals, indicators, and timeframe analysis, as well as the numerous comparisons of swing vs trend trading, pro vs amateur thought processes, and how certain indicators can be effectively used or in inappropriately applied in different situations.

As with Elder's other books, there are countless gems that would make excellent post-it notes for a trader's computer screen. There are very few 'educators' that come across as credible successful traders, but I believe Elder fits the bill.

I recommend the book and I will incorporate elements from the book into my own trading. I have read the book twice now and I plan to revisit the text in the future. A summary of major lessons learned and some quotes from the book are detailed below.

Audience – The book appeals to a wide audience, from beginner to experienced traders, and it is intended for beginner and intermediate traders. The book touches on many different aspects of trading and I have picked up nuances and new ideas on subsequent reads.

Title – Strangely, I think "Trading for a Living" would be a better title for the book – however this is the title of another Elder book (which should also have a different title – see my other book review)! Come Into My Trading Room is the title of the third section of this book, but it is the smallest section. The subtitle, A Complete Guide to Trading, is ambitious but not inaccurate.

Disclosure – Nothing to disclose, I do not know Dr. Elder and have no affiliation with him nor Financial Trading Seminars, Inc. I bought the book myself on Amazon.co.uk. If you go the "Gift Shop" section of stoictrading.wordpress.com you can click through to Amazon.com or Amazon.co.uk to purchase it.

Lessons Learned or Reinforced in Come Into My Trading Room

Trade Management:

- Professionals enter trades cautiously but exit fast. Beginners jump into trades without thinking too much and take forever to get out.
- SafeZone stop placement is a strategy for swing trades based on average market noise range; Chandelier stops are a strategy for trend trades based on a multiple of ATR.

Trade Identification:

- Triple Screen – trade with longer term trend, fade intermediate moves, enter/exit on short term charts.
- MACD Divergence on longer timeframes (D1, W1) is the best signal in technical analysis.
- Technical analysis tools will work for you only if you have the discipline to wait for patterns to emerge. Professionals only trade when markets offer them special advantages.
- Indicators (and timeframes) often contradict each other. Know clearly what signals indicate, why you are taking a trade, and when to get out.
- Chase fat rabbits, don't waste your time on skinny ones.

Record Keeping:

- Keep good records, learn from past mistakes, and do better in the future. Keep a trading diary and put a performance grade on every trade.
- To measure your level of discipline and improve it, you must maintaining and learning from several sets of trading records.
- Keeping good records is the single most important contribution to your success. Elder recommends four types of records: a list of all trades, details, outcome, grade; an equity curve; a trading diary (screen print at entry and exit, with thesis and thoughts), and a trading plan for the day ahead.

Psychology:

- If you cannot make money with dailies, shorter time frames will only help you lose faster. The problem with losers is not that their data is too slow, but their decision-making process is a mess.
- Simplicity and discipline go hand in hand. To be a successful trader, choose a small number of markets, select a few tools, and learn to use them well.
- Once beginners gain a little experience and confidence and increase their trading size they start losing. Their system hasn't changed, but bigger size makes them a little stiffer and less nimble.

General:

- One-bar-at-a-time forward testing is superior to what you get from backtesting, where the output can be misunderstood and give a false sense of security.
- An occasional whipsaw is the price of long term safety.
- Day-trading places extreme demands on its practitioners; and paradoxically demands the highest level of discipline, while attracting the least disciplined personalities.

Quotes from Come Into My Trading Room

P12. "The normal behavior of the crowd is to mill around, make noise, and go nowhere. Once in a while a crowd becomes excited and explodes in a rally or a panic, but usually it just wastes time."

P12. "Fast-moving markets give the best trading signals. When crowds are gripped by emotions, cool traders find their best opportunities to make money. When markets go flat, many successful traders withdraw, leaving the field to gamblers and brokers." [in my opinion this is particularly the case for Elder's preferred style of trade]

P20. "Futures can be very attractive for those who have strong money management skills. They promise high rates of return, but demand ice-cold discipline."

P22. "You can be sure that whatever the majority of traders does, believes, and says, is not worth doing, believing, and saying."

p26. "Transaction costs can raise an impassible barrier to winning. Beginners hardly think of them, yet transactions are a leading cause of trader mortality."

P29. "Slippage tends to be a much bigger expense than commissions." [abandon brokers that show a tendency for slippage in their favour]

p39. "Analysts are paid to be right, traders are paid to be profitable. Those are two different goals, calling for two different temperaments."

P42. "Amateurs often misuse technical analysis by looking for indicators that show them what they want to see." P46. "Technical analysis tools will work for you only if you have the discipline to wait for patterns to emerge. Professionals only trade when markets offer them special advantages."

P43. “Technical analysis, no matter how clever, is only responsible for one third of your success. You also need to have sound trading psychology and proper money management.”

P48. “A person who does not know what his edge does not have it and will lose money.”

P51. “To be a successful trader you must accept total responsibility for your decisions and actions.”

P52. “There is a rule in the advisory business – if you make forecasts for a living, make a lot of them.” [I see this all the time amongst the advisor community, in hindsight they can always point to 'many' correct calls.]

p55. “You need to become a self-aware trader. Keep good records, learn from past mistakes, and do better in the future.” P56. “Good records are a sign of self-awareness and discipline. Poor or absent records are a sign of impulsive trading.” P65. “Keep a trading diary and put a performance grade on every trade.”

P60. “Most amateurs won't admit they are trading for entertainment.”

P62. “Healthy trading boils down to two questions you need to ask in every trade: “What is my profit target” and “How will I protect my capital”.

P70. “If you are a short-term trader, pay attention to the opening range – the high and the low of the first 15 to 30 minutes of trading. Most opening ranges are followed by breakouts, which are important because they show who is taking control of the market. Several intraday trading systems are based on following opening range breakouts.” [I've also noticed the importance of the overnight range in forex trading]

p75. “[For trendlines that] rise or fall at 60 degrees or more, their breaks tend to lead to major reversals. This sometimes happens near the tail end of runaway moves.”

P75. K-tails - “The market tests a new high or new low with a bar that is much taller than the preceding and following bars, and then recoils from that price extreme. You can recognise a tail during the bar that follows, and trade against it.” p77. “Once long, place a protective stop approximately half-way down the tail. If the market starts chewing its tail, run without delay.”

P79. Breakouts - “If you get stopped out on a false breakout, don't be shy about getting back into the trade. Beginners tend to make a single stab at a position and stay out if they are stopped out. Professionals, on the other hand, will attempt several entries before nailing down the trade they want.”

P83. “Volume gives traders several useful clues. A one-day splash of uncommonly high volume often marks the beginning of a trend when it accompanies a breakout from a trading range. A similar splash tends to mark the end of a trend if it occurs during a well-established move.” P84. “Divergences between price and volume tend to occur at turning points.”

P84. “An amateur tries to grab a bit of money here and there. He uses one technique today and another tomorrow. His mind is scattered and he keeps losing.”

P84. “Simplicity and discipline go hand in hand. To be a successful trader, choose a small number of markets, select a few tools, and learn to use them well.”

P87. “Indicators from different groups often contradict each other.”

P94. “If we buy high above the EMA, our actions say, “I am a fool, I am over-paying, but I hope to meet a greater fool down the road who will pay me even more.”

p97. “If you buy near a rising moving average [when long-term trend is up], take profits in the vicinity of the upper channel line. If you sell short near a falling moving average, cover in the vicinity of the lower channel line.”

P97. “Channels catch swings above and below value but not major trends.” P98. “Amateurs think that every breakout will be followed by a massive runaway move. Once in a rare while they are right, but in the long run it pays to bet like the pros. They use channels to find when the market has outrun itself and where it is likely to reverse.” P101. “Why do so many people lose so much money day-trading? There is simply no enough height in intraday channels to make profits. The chances of becoming a successful day-trader are very low because the channels on intraday charts are not high enough.”

P98. “Professional traders, once they find a technique that works for them, tend to stay with it. They'd rather miss a trade than change to an unfamiliar style.”

P106. “The strongest signal in technical analysis is a divergence between the peaks and bottoms of price and MACD-Histogram. A divergence occurs when the trend of price highs and lows goes one way and the trend of tops and bottoms in MACD-Histogram go the opposite way. Those patterns take several weeks or even more than a month to develop on the daily charts; it occurs rarely, only a couple of times per year on the daily chart.” P107. “Go short when the MACD-Histogram traces a bearish divergence, that is, when prices rise to a new high but the indicator ticks down from a lower peak.”

P117. “Stochastic measures the capacity of bulls to close prices near the top of the recent trading range and the capacity of bears to close them near the bottom.” P119. “This indicator work well only if you use it with a trend following indicator and take only those stochastic signals that point in the direction of the main trend.” P121. “Do not buy when stochastic is above its upper reference line and do not sell short when it is below its lower reference line. These “no go” rules are probably the most useful messages of stochastic.”

P124. Mechanical Trading: “A pro who puts his system on autopilot continues to monitor it like a hawk.” P124. “In my experience system traders tend to achieve more consistent results, but the best and most successful traders use the discretionary approach. The choice depends on your temperament rather than a cold business decision.”

P125. “You must test each indicator, rule, and method before including them in your trading system.” P127. “One-bar-at-a-time forward testing is vastly superior to what you get from backtesting software.”

P127. “Your system must include certain absolute rules, most of them concerning money management.”

P130. “Different groups of indicators often give conflicting signals. A trader must set up a system that takes all groups of indicators into account and handles their contradictions.”

P130. “People who have lost money with daily charts often imagine that they could do better by speeding things up and using live data. If you can not make money with dailies, a live screen [shorter time frames] will only help you lose faster.”

P131. “The problem with losers is not that their data is too slow, but their decision-making process is a mess.”

P131. Triple Screen: “Triple Screen resolves contradictions between indicators and timeframes. It reaches strategic decisions on long-tern charts, using trend-following indicators [1]; it proceeds to make tactical decisions about entries and exits on the intermediate charts using oscillators [2]; and it offers several methods for placing buy and sell orders from short term charts [3]”.

P132. Screen 1, long term (say, weekly): “Apply trend-following indicators to the long-term chart and make a strategic decision to go long or short. When the weekly EMA rises if confirms a bull move and tells us to go long or stand aside. When it falls, it identifies a bear move and tells us to go short or stand aside. I use a 26-week EMA. Divergences between weekly MACD-histogram and prices are the strongest signal in technical analysis, which override the EMA.”

p134. Screen 2, intermediate term (say, daily): “Use oscillators to look for trading opportunities in the direction of the long term trend. When the weekly trend is down, look for the daily oscillator to rise giving a sell signal [over-bought, i.e. fade strong counter-trend moves].”

P136. Screen 3, short term (say, H1 or H4): “When the first two screens give you a buy signal (the weekly is up, but the daily is down), place a buy order at the high of the previous day or a tick higher.”

P136. “An occasional whipsaw is the price of long term safety.”

P136. “You should move your stops only one way – in the direction of the trade.”

P138. “Do not be distracted by intraday chop if you are trading swings that last several days.”

P138. “Day-trading offers advantages and disadvantages, while placing extreme demands on its practitioners.” P143. “The great paradox of day-trading is that it demands the highest level of discipline, while attracting the most impulsive, addictive ad gambling-prone personalities. Successful day-traders test patterns and systems, measure risks and rewards, and focus on building equity. Winners tend to be emotionally cool.” P150. “Taking [holding] a loss overnight is strictly for losers. A beginner must close his day-trades by the end of the day.”

P144. “Are you successful trading with end-of-day charts? If the answer is no, stay away from day trading. You need a minimum of 1 year successful trading experience before attempting to day-trade.”

P144. “Volatility refers to the average daily range of your trading vehicle. The greater the distance between the high and the low of the day, the bigger your target. Shooting at a big target is easier than shooting at a tiny one.” P158. “Chase fat rabbits, don't waste your time on skinny ones.”

P148. “Looking at too many timeframes can lead to paralysis from analysis.”

P153. “Successful traders test everything.”

P154. “If you trade currencies, you should either take a very long-term view and ignore daily fluctuations, or else day-trade, avoiding overnight positions.”

P155. “There is always a mass of sell stops below the low of the opening range and the low of the day. There is always a mass of buy stops at the high of the high of the opening range, the high of the day, and the high of the previous day, placed by weak shorts.”

P161. “Beginners jump into trades without thinking too much and take forever to get out, hoping and waiting for the market to go their way. The professional approach to trading is the total opposite of the amateurs style – enter cautiously but exit fast.”

P165. “There are two main arguments for deciding on an exit before you enter a trade. First, knowing your targets and stops allows you to weigh rewards and risks. Second, setting profit targets and stops before entering trades helps sidestep the pernicious “ownership effect”. We get attached to things and lose objectivity.”

P167. “Entries are easy because any clown can buy a lottery ticket, but exits separate winners from losers.”

P168. “Traders take a good system and destroy it by trying to make it into a perfect system.” - Robert Prechter

P171. “Placing stops is one of the hardest challenges in trading, more so than finding good trades. You want to place them close enough to protect your capital, but far enough to avoid being stopped out by meaningless noise. It is a delicate balancing act.” P173. “Placing a stop is one of the hardest questions in technical analysis.”

P173. SafeZone Stops: “When the trend is up, we can define noise as that part of each days range that protrudes below the previous day's low. When the trend is down, we can define noise as that part of each day's range that protrudes above the previous day's high. SafeZone measures market noise and places stops at a multiple of noise level away from the market.” P179 “[when looking back to calculate average noise,] Do not go back beyond the last important turning point.” P191. “The SafeZone stops, which work so well for swings, are much too tight for big trends.”

P180. Chandelier Exit: “Catching swings calls for tight stops, but a longer-term position demands more breathing room. The Chandelier Exit is designed to protect such positions [and is calculated by] subtracting the Average True Range, multiplied by a coefficient, from the highest point reached by the trend.”

P188. “Should you trade the long-term trends or short-term swings? Be sure to decide before you put on a trade.”

P188. “Successful trend trades that catch large moves bring in more money per trade. Other advantages include having more time to decide when to enter or exit, not being tied to the screen, and having the emotional satisfaction of calling major moves. Trend trading does, however have its

drawbacks. The stops are farther from the market – when they get hit, you lose more. Also, you have to sit through long periods of inactivity, which many people find hard to tolerate, and you miss many short term trading opportunities. Swing traders have more opportunities than trend traders, gaining more experience from frequent trades. The dollar risk is lower thanks to closer stops and quick rewards provide emotional satisfaction. Swing trading also has its drawbacks. Expenses for commissions and slippage are higher due to more frequent trading. You must work every day, actively managing trades. Also, you are likely to miss major moves – you can't catch big fish on a small hook." P193. "Swing trading, like fishing, demands a great deal of attention and patience." P193. "Early in your trading career, it is safer to concentrate on swings."

P189. "Should you trade trends or swings? My impression, after meeting thousands of traders and investors, is that the elite tend to trade the big moves and ride major trends, but people who can do it successfully are few and far between. There are many more traders who make money by trading swings."

P190. "A new breakout is easy to recognise but hard to trade and even harder to hold."

P213. "A minicontract is only one-fifth [the] size [of a normal contract]. The only advantage of minis is the reduction of risk, but their commissions take a bigger percentage from each trade. Beginners may use them for practice, but full-size contracts are much better trading vehicles."

P220. "Limit your loss on any trade to 2% of equity in your trading account." P225. "Whenever the value of your account dips 6% below its closing value at the end of last month, stop trading for the rest of this month."

P229. "Beginners often make money on small trades. They gain a little experience and confidence, increase their trading size – and start losing. Their system hasn't changed, but bigger size makes them a little stiffer and less nimble."

P235. "The trait that all winners have in common is a very high level of discipline. How can you measure your level and then increase it? You do it by maintaining and learning from several sets of trading records."

P235. "Keeping good records is the single most important contribution to your success. P236. A trader needs four types of records: the trader's spreadsheet [list of all trades, details, outcome, grade], his equity curve, his trading diary [screen print at entry and exit, thesis and thoughts], and a trading plan for the day ahead."

P251. "Trading is an old man's game. Patience is a virtue and memory is a great asset."

P259. "Drafting an intelligent trading plan requires a huge amount of work."

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If you go the "Gift Shop" section of http://stoictrading.wordpress.com you can click through to Amazon.com or Amazon.co.uk to purchase the book.