MARKET WISE
STOCK TRADING SCHOOL, LLC.

"Breakfast of Champions"

LETTING YOUR PROFITS RUN; WHEN NOT TO SELL

So much attention and instruction given to new traders these days stresses discipline. There is no question that discipline will dictate your long term success or lack of discipline will determine your short term failure when it comes to trading. There is the discipline to admit when one is wrong in a trade and take the corresponding action to exit the position. There should be discipline to cut losses quickly. As well, ones discipline should keep them from averaging down on positions when this is not one's original gameplan.

One discipline that fails to receive the same level of commentary as the ones we have mentioned; is the discipline to stay in a trade that is going ones way. This is actually more of a difficult situation to quantify and more of a skill that takes time to feel confident with. It sometimes involves years of trading and exposure to the markets to get that true feel. The common phrase is referred to as " Letting Ones Profits Run ". Many new traders fail to feel confident enough in their trading ability and have yet to develop the patience that is needed to stay with trades and as a result are too quick to exit a position that still has profit potential. We will try to address this phenomenon and share some ideas and ways of perhaps picking ones exit points better when in profitable trades or at least present some ways of staying in profitable trades a bit longer. We all know the feeling of exiting a position and then instantly realizing we have exited too early as the stock continues its profitable path but we are no longer on board. Some in the industry comment that as a trader you shouldn't beat yourself up when you make money even though you have left money on the table. There is some truth to this as an inexperienced young trader but as a trader matures one needs to be able to press or be aggressive with their trading when they are in the zone and capitalize on those occasions and times when things are going right. When looking at the absolute numbers, historical studies have shown that most traders are wrong more times than they are right. Trading, however, is not about always being right it is about making money and preserving capital for the times when one is right. Remember many professional traders are only right on 30% of their trades but these trades are leveraged or squeezed to their full potential enough so to more than offset their more frequent manageable losses.

So let's move on to discuss the thought patterns and actions that can be used to aid us in staying with trades and becoming better traders.

One relatively simple concept that we have talked about in the past in light of other trading strategies but one that applies here as well is that of scaling out of a position that is in ones favor. When being long 1000 shares we might sell 500 first and then sell the second 500 later. It is difficult to quantify but ask any trader who has been around a while and they will tell you that often its not until they sell a position that they then realize it is going higher. The action of offering stock and seeing how long the order stays live as well as how the shares are filled tells one about how the stock is acting. For this somewhat mysterious reason one can often be able to assess their position more objectively if they lighten up on their overall position by selling 50% or 30% or some initial percentage one as a trader is comfortable with. Furthermore, it hopefully will by one a bit more time to see how other market forces are reacting and help to confirm exiting the position entirely or a least mentally adjusting ones stop price.

Remember as well that as a trader one should try to avoid using the price level of a stock as the sole determinant of when a position should be covered. This is one element to the puzzle but one really needs to look at how a stock is acting. Traders like to buy stocks that are acting well and sell stocks that are acting poorly regardless of price level. The stock that you are long at 80 and is quickly trading at 81 may be going to 85, no one knows. One needs to compare the conditions surrounding the stock at 81 as they compared the stock at 80 when they initially got in to the trade. If the conditions are relatively the same one may try to stay with the trade until they see a condition change.

Another approach is for a trader to try to step outside themselves and their position and imagine they do not have a position on. From here the trader may ask, " Would I go long from here?" "Is there a good risk reward scenario to be played at this point in time as if the past did not happen?" Realize that this thought process can be difficult for new traders and it is difficult for all traders to continually step outside themselves and to mentally assess a somewhat hypothetical situation.

Taking this a step further, however, one needs to realize that there is always a contra party to every trade and one should try to step inside the shoes of the trader who potentially will be on the other side of the trade and look at the motivations and risk reward equation that the contra side may be piecing together. For example, if one is long stock at 81 and the market is trading at 81 ¾ try to put yourself in the shoes of the trader who might be looking to short at 81 ¾. Does this trader have an upside stop loss point that they may be leaning on? Is there a technical level that the other side of the trade may be looking to get short against? Can the other trader build a scenario of limited risk with greater reward? If your own answer is no or not very well then you may want to give the trade a bit more room to go.

Perhaps one of the most critical elements that needs to be in place before a trader is going to be able to let their profits run is a traders confidence in themselves that they can set an exit point and stick to it. If a trader consistently finds himself "in the money " on trades only to have trades come back through their initial entry point and then winds up losing money this can be extremely detrimental towards a traders ability to stay in profitable trades. A trader becomes increasingly trigger happy at the slightest retracement of a winning trade because they mentally envision the potential for a losing trade before it even becomes one. When a trader trusts that he can exit a trade at his predetermined level he can better focus on the trades that are happening in his favor. He can more objectively assess the “now” of the trade instead of addressing the “now” and the “later” of the trade at the same time.

Finally letting profits run involves patience. Patience comes through being around the markets consistently and realizing that there will always be another trade. Good traders let their trades play out and they are not second-guessing lost opportunities that they think are happening around them. Good traders become comfortable letting trades go by when they can not build a trade scenario they are used to. One must learn from their mistakes and not regret what has happened in the past but always be looking to the future.

Hopefully, this discussion has provoked some to see their trading in a slightly different light or has opened up for some avenues to explore their trading in a more constructive way. Thank you and good luck trading.