The 7 Deadly Sins of FOREX
(and How To Avoid Them)

By Marc Low

Introduction

Some 12 years on in my investment "career", I sat down to reflect upon my successes and failures. More to the point, I sat down to reflect upon the *causes* of my successes and failures, for that information is always for more important than the specific events which resulted. This personal reflection was driven both by the desire to improve my future performance, but also by the need to answer the age-old question, "What makes a good investor?" I decided to consult the dictionary for a definition of the term:

Invest (ĭn-vĕst')

v. 1. To commit money or capital in order to gain a financial return.

2. To devote morally or psychologically, as to a purpose; commit.

I was fascinated by the definition. The concept of financial investment is an interesting one for obvious reasons; everyone wants to know how they can turn money they've already earned into **more** money. Unfortunately, this desire to grow one's after-tax dollars is all too often accompanied by unrealistic expectations. Beginners to the game often hope for annual returns in the hundreds or even thousands (!) of percent, and there are far too many snake-oil salesmen willing to stoke those dreams with impossible promises.

To the outsider, investing often seems a dark, mysterious activity, shrouded in secrecy. Success seems elusive, if not downright impossible. Names like "Soros" and "Buffett" are oft-mentioned. Tips are exchanged in hushed tones. This program or that program is the newest “Holy Grail” of the investment world. Beginners often float from system to system, looking for that special something that will bring them the riches they desire. All too often, the second definition is ignored.

Success in investment requires a certain psychological devotion to the purpose. Far too many investors expect full-time income from their investments, with only a part-time (or less) investment of energy and focus. This cannot be, for as the old saying goes, “You don’t get something for nothing.” Interestingly enough, while investors of all colors hold up Warren Buffett and George Soros (among others) as the flag-bearers of the craft, few stop to analyze the examples. Both men are rich almost beyond imagination, yet how did they get to where they are today? Their seeming overnight success was in fact not overnight at all, but the result of years and years of steady, compounded returns.

Berkshire Hathaway, the investment group founded by the legendary Warren Buffett, has earned, on average, a little under 25% return annually. Certainly these returns are far better than the S&P 500 average of 9%, but by no means are they in the hundreds or thousands of percent. And yet Berkshire Hathaway stock trades at nearly $100,000 per share, and Buffett stands as one of the richest men in the world.

George Soros is another great example of legend distorting fact. His role in Black Wednesday (September 16, 1992) is well publicized. Soros’ Quantum Fund sold short nearly $10 billion dollars worth of British Pound, and forced the Bank of England to float its currency or face collapse. This bold move netted Soros and his associates over $1 billion dollars profit. Not bad for a day's work, certainly, and enough for a few tanks of gas in the limo without question, yet the return on capital was around 10%. The returns were large; so was the investment.

The purpose of this book is not to discourage traders or investors; quite the opposite. I have attempted to distil my years of experience, and those of fellow investors I've met along the way, into a short list of potential "booby-traps". Assuming your technique and money-management principles are sound, being aware of these potential pitfalls will, I hope, greatly improve your odds of success. Good luck!

Deadly Sin #1: Impatience

In trading terms, impatience rears its ugly head in major and minor ways, both of which are significant.

On a major level, traders of all markets and experience levels tend to fall victim to impatience when it comes to expectations of returns. An attitude exists (especially among newcomers) that success is a given, and that it must appear quickly and without much effort. Nothing could be further from the truth. I say especially among newcomers because, as any successful, experienced investor/trader will tell you, investing is a long-term proposition. Success is measured in years, not weeks or months. Because of this tendency to expect the unrealistic, investors tend to easily slide into Deadly Sin #2: Lack of Clear Vision, because the grass is always greener on the other side. The tendency of all investors to become impatient with their system or technique is simply greed rearing its ugly head. Think you're not the greedy type? Put some money in the market and you'll soon learn otherwise. We all have a little voice in our head looking for more; some of us just have a voice that speaks louder than the next person's.

On a minor level, or more accurately, on a practical level, traders often fall victim to impatience whilst in a trade. How many people can relate to the following scenario?

You analyze a particular currency pair. The criteria you've established for entering a trade are met. You set your stop loss and your profit target, and you pull the trigger; you're in. Suddenly, now that you're actually *in* the trade, things look different. There's a level of resistance where there was none a moment before. The entire chart looks like a booby trap, just waiting to gobble up your trade. "If I can just get through *this* level, or *that* level…" you tell yourself, cursing your quick mouse-finger. The sweat starts beading on the forehead. You feel a bit queasy, but you're not sure if it's from excitement or anxiety. You clear the "spread", and you're actually showing a few pips of profit. "I knew it all along," you say to yourself, and pat yourself on the back.

Suddenly, the market reverses course. You're in the negative again. Now you're shouting at the screen, and quite sure that the nausea is anxiety-produced. You reach for the Pepto-Bismol as the sweat starts pouring. This continues for another few minutes (or hours, or days, depending on your timeframe), and each time you feel a little worse about the trade. Finally, unable to take another moment of this excruciating torture, you glimpse a few pips of profit, and take it, closing the trade. At that exact moment (or so it seems), the market explodes, running to your profit target and beyond.

"Son of a...! I *KNEW* it!"

How many of us have experienced this exact scenario? This inability to see the trade through to its conclusion is often caused by a lack of belief in the system or technique being employed. If you believed 100% in the reasons for being in the trade, you wouldn't be anxious to get out.

SOLUTION:

We've talked about two different levels of impatience here. For the more major impatience, relating to the overall returns being generated, it's important to take a step back and re-evaluate your expectations. Some questions that may help:

Are your expectations realistic?
If you are expecting returns in the hundreds of percent a year, is that pace sustainable long term?
What are your long-term financial goals?

Another tool that helps to soothe the ego is the Rule of 72. The Rule of 72 is a quick calculation you can do to estimate how long it will take to double your money given a particular percentage return over time. Simply divide the return you are getting into 72 and voila, that's how long it will take to double your money.

For example:

Assume you earn an even 10% annually, year in, year out.

72 / 10 = 7.2

So, earning 10% annually will take you 7.2 years to double the initial investment.

Often when I show this tool to a student, they are surprised by the result. They may have thought that 10% annual returns would take forever to double their money, when in fact it only takes 7.2 years of consistency. Play around with the calculation on your own; you may be surprised with the results.

For the more practical challenge of impatience, namely, impatience with a particular trade, confidence is key. How do you gain confidence? Practice, practice, practice, then practice some more. Demo accounts are quite possibly the single greatest addition to retail investing. Why? Because it gives new traders the ability to simulate real-world conditions without the ability to "cheat" by fudging the numbers like the paper trading days of old.

The only really stressful trade should be the first one with real money. Why? Because your profitable demo trading results will now be put to the test with real dollars. Once the system is proven in real-time, there is nothing left to do but follow the rules of the system. New traders typically get nervous because they are unsure of their system, and are hoping for a successful outcome; experienced traders *expect* a successful outcome, so nervousness doesn't apply.

Deadly Sin #2: Lack of Clear Vision (Flip-Flopping)

As I mentioned in the first section, the sin of flip-flopping is closely related to the sin of impatience. Why? Because by nature, investors want more from their investments. If a particular strategy isn't yielding strong enough returns (or so the individual thinks) there must be something wrong with the strategy. And so it begins.

This is one of the most common problems I've encountered in traders over the years. Often I will meet someone who has been struggling away in the markets for years, always chasing the next big thing. They believe to the depths of their soul that *this* strategy or system is *the one*. Big things are only a few trades away. They don't realize that the problem most often lies not with the particular system, but within themselves.

Before you say it, of course some systems just plain don't work. I believe there is a special place in the afterlife reserved for those snake-oil salesmen (and there are plenty out there) who claim to have simplified a financial market down to a couple of arrows or a few lines on a chart. By and large, speculation on future movement is a difficult task, and most amateurs don't fare particularly well. This is one of the reasons why Unique FX tries to remove the element of speculation as much as possible from our strategy, and instead relies on market dynamics to generate returns. But I digress…

SOLUTION:

If you invest in a new system or technique, give it some time. Success is measured in hundreds or thousands of trades, not just a handful. No one can say with any certainty after only a few trades whether something is a success or not. Budget your time, energy, and capital wisely. Lay out a schedule for testing. If after several weeks (or months) of **DEMO** (!) trading, the strategy is yielding positive returns, begin trading with real dollars. But never, under penalty of drained accounts, begin trading a strategy unless it has proved itself in a virtual environment. Investing real, after-tax dollars makes things more difficult, not easier.