How to Build a Position

Formulating good trading strategies and views on the market is all well and good, but if you don't have a proper way of entering your positions in an orderly manner then you may find your trade in the red the minute you enter the market.

SCALING

It is common knowledge that the ideal way to trade is to gradually enter a position, and then gradually exit as your targets are met. In theory this approach is beautiful; in reality most traders will find it very hard to accomplish. It is hard to add an increasing amount to your position when it looks worst, and hard not to take profits once it moves into the black. The psychological aspect is often times too great and lucky are the few that can sit still while the market gyrations make your P/L swing like a kite in the wind.

One way to get around these considerations is to take small chunks out of the market instead of going for the entire move. Taking profit in a trade is very important not only for the balance sheet, but also for your psyche. Profit taking breeds a positive mentality that all traders need, and in case the position turns around and you end up with a loss, at least you put some pips away to soften the blow.

BUILDING A POSITION

Trying to time the perfect entry/exit is a fruitless exercise engaged by traders that serves only to hinder your trading. Professional traders know that they are not likely to enter at the "exact" top or bottom, so instead they focus on figuring out the price range for their entry.

Let's take a look at a real-world example using the loonie (USDCAD):

Because of our technical analysis and interpretation of the price action, we think the loonie is poised to fall and enter a short position (chart A.7).

According to our money-management guidelines, our risk should be no more than $200 on a $10K account (2%). We have two options:

- One 100K lot with a 20 pip stop.
- Multiple mini lots with varied stops.

Chart A.7

You can immediately see the flexibility you give yourself by trading smaller lots, which is exactly the reason most retail traders should trade mini accounts. Your *total* risk should be what's important to you, not nailing the exact entry point. Most FX platforms these days calculate your average cost automatically, so figuring out the risk on multiple positions is fairly easy to accomplish.

Let's say we decide to trade 5 mini lots (leveraging 5 times). If we where to trade them all at once, then we would need to set a 40 pip stop. We are risking the same amount ($200) but at a lower risk profile. The more experienced you get with your trading, the more comfortable you will be in varying your entries and stops.

Of course, before we are even close to entering the trade we will already have charted out the day's trading levels which we can use to enter and exit the trade. With five lots to trade, we begin to enter incrementally higher amounts once our entry price is reached.

Chart A.8

1. **First sell order executed @ 1.1330**
   Just getting our feet wet, making sure we have an "interest" in the market.

Now, one of two things can happen. The more common one is to see the price shoot up as soon as we enter our short. This is when most traders scream "this always happens to me!", but in our case we are just happy to see better selling levels. On the other hand, if the pair proceeds to immediately plummet, then our position would already be in the black. Not a bad place to be. Starting small means putting yourself in a win-win situation.

2. **The loonie moves higher and we sell 2 more @ 1.1345**
   We are now short 3, and we have two more bullets remaining.

After a few minutes, the pair continues to move higher and is sitting at 1.1355, 25 pips above our original entry. If the rate continues to climb higher, we still have 2 more lots to better our cost, or if we feel uncomfortable with the trade we can choose to exit with a meager loss. Using the one-lot strategy, we would have already been stopped out.

3. **The pair finally begins to come off and gains downside momentum. We enter our final two shorts @ 1.1333**
   We are now short 5 avg. cost 37.

Note that this is not "averaging down," which is a desperation move. This is building a position. We were able to get a better cost for our short (37 compared to the initial 30) and managed to ride the blip higher that stopped out many of your fellow traders.

Once the topside stops are taken out, the trade now has room to move on the downside. We exit according to our support levels, taking out 2/3 and leaving the rest with a stop at entry looking for lower levels.

Big traders rarely trade with fixed orders in the market (for fear of revealing their intentions), and enter and exit positions according to price action. This type of trading is probably best suited for experienced traders with established trading styles, while new traders are better-off trading with multiple fixed orders in the market which lets them focus on tweaking their analysis instead.

Building a position means establishing ranges for you to trade off of, rather than trying to define absolute values for the perfect entry. In the FX market there is so much intra-day noise that trying to find the perfect entry and exit of any trade is practically impossible; so why bother? Instead of thinking "at what price should I enter," you should be thinking "what is a good 10-15 pip range to enter/exit my positions?" As long as your analysis is correct most of the time, you should be able to make money most of the time as well.

TRADE YOUR TIMEFRAME

Once in the trade, a crucial mistake some traders make is to trade out of their time frame. Once in a trade, it can be tempting to scour different charts in order to find some glimmer of hope that may turn that losing trade into a winner. A trade opened according to the 3 minute chart will turn sour, but a stubborn trader will not let go and turn to the 15 min or 30 min charts where the trade looks better. As you may have guessed, this never works and only opens the door to larger losses and more pain for the trader.

Learn to cut your losses short. If you opened your trade according to a signal from the 3 min chart, get out as soon as the 3 min chart tells you the trade is no good. It's no use to flip time frames until you find a chart that suits your needs; remember that you are following the price action, not the other way around.

The only time it's appropriate to switch time frame is when the trade is deep in-the-money. If the signal came from the 3 minute chart but extended farther than you thought, it may be reasonable to think that the move has further to go. Switching to a longer time frame may show you the market rolling over and confirming the signal. In this case it is wise to take some profit and let the rest run, but a good rule to follow is to get out according to the time frame you used to enter the trade. If your original analysis was incorrect, then you can't to turn a loser into a winner; no matter what fancy indicators or software you may use. Trash in . . . .trash out, as they say.