

J A N U A R Y 2 0 0 5

Automated Trading

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The debate rages on: what's the best way to capture profits in forex – hard work or automated trading? For someone who wants to trade their own systems, the answer is clear: both. Hard work is the foundation of all profitable automated trading systems.

ANALYSIS

- Why is automation of particular use in forex trading?
- What are the major components of automation?
- What does the ideal automated system look like?

ACTION

- Evaluate the systems that allow you to automate.
- Select, test, and implement the platform of choice.

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ABOUT THIS REPORT

The Forex Report is a periodic publication that investigates advanced strategies for superior trading performance in the foreign exchange markets. These reports utilize advanced statistical and econometric modeling techniques to create new insight into the trading strategy of the average trader. This Core Concept Brief, Automated Trading, is intended for traders with all levels of forex trading experience and technical analysis understanding.

To learn more about The Forex Report or to register for delivery of all future reports by email, including Case Studies & Data Briefs, please visit www.fxengines.com.

ANALYSIS

Do you want to work hard or work smart? That's the real question. Building automated systems is hard work, but it's hard work with a payoff. Manual trading may work for stocks and futures, but it won't cut it in forex for most traders.

Forex is unlike any market in the world. It's open for trading 6 days a week, 24 hours per day. It's dominated by multinational corporate treasuries, massive investment funds, and national banking and economic agencies. There are daily price swings that would make most fund manager's yearly quota. It all adds up to a lot of risk for the average investor, but there are ways to minimize the risk and take advantage of the huge opportunity.

When the average trader first learns of forex trading, it's all dollar signs and big dreams. The daily volume and profit potential lead many to believe that huge success is just a few pips away. While it's true that forex presents a large and unique opportunity for traders, it's also true that most traders are overwhelmed not long after their first few trades. Why?

There are too many chances to make money. Without the discipline to really hold to a system, most traders experience a wide array of events that eventually lead to account liquidation. The temptation to jump back in after a loss or gain, the misuse of leverage, the total absence of money management techniques, and many other ills befall the trader who sees one opportunity after another. Soon, physical fatigue sets in, then mental fatigue, and in the end trading becomes a vicious circle of what-ifs and could-have-been's.

Emotion is the true culprit – whether it's the ethereal highs we experience after gains or the remorseful lows we feel after losses. The trader needs to optimize moments of clear-headedness and objectivity to build systems free of the stress of trading. Once the system is built, the trader has to have the discipline to trade it EXACTLY as it was built. For a variety of reasons, that ability seems to be lacking among all but the top 1% of traders. The rest of us need automation.

COMPONENTS OF AUTOMATION

Every automated trading platform should have 4 major components:

- Signals** – Signals are the events that trigger market entry and exit. The platform you choose should have sufficient breadth and customizability of signals to meet your system's trading needs.
- Systems** – Signals are combined in a script for trade entry, trade management, and trade exit, also known as a trading system or trading engine.
- Test Trading** – Completely formed engines are tested historically using tick data, and then on a forward-looking basis using a live market price feed.
- Live Trading** – Tested engines are elevated to live trading status, where a reputable forex dealer executes trades in a real money account.

Caveat Emptor! Many platforms claim to be a complete solution, but close scrutiny can usually reveal one or more flaws. Decide if you can live with those flaws and if not, move on.

THE IDEAL PLATFORM

Automation, in its best implementation:

- Provides *exact* execution of a trader's system. The ideal automated trading platform allows a trader to work in a test environment with the exact same set of tools that will be used live. It allows the trader to build systems, test them, and implement them live in such a way that the trader knows that the live system will execute trades exactly as the test system did, and similar performance should result.
- Frees the trader from the majority of physical and emotional demands that are particularly forceful in the 24 hour, large player dominated world of forex trading.
- Makes money for the trader!

ACTION

All traders have different levels of programmatic skill and different needs for customization. There is an automation option for most traders, and the most important factor in determining which to use is trust.

The first step in automation is platform selection. Here are the points to consider:

- Do you need automation? The answer is yes for most traders. The answer is no if you've consistently made money trading forex.
- Is your automation platform hosted? If not, then your trading success relies on your home or office computer. Redundantly hosted platforms will inspire the most confidence among traders.
- In your platform tic-driven? If not, your live trades are not likely to perform as well as your historical tests.
- Is your platform partnered with excellence? Look at the dealers and other partners chosen by your platform. Are they the best in their field? If not, be wary.
- Does your platform require up-front payment? This is always a red flag. A platform confident in its ability to make you money will share the risk of getting you started.
- Does your platform support your need for customization, or is it programming-reliant? Ease of use is a big deal – forex is tough enough as it is!

Of course FX Engines is all of these things and more. While we hope to be your chosen platform we realize that you may prefer another platform. If so, let us know. We'll be happy to evaluate any third party trading platforms and point out the pros and cons of each, free of charge.

No matter what you choose, we believe that choosing automation is a choice for success. Be cautious, but get busy. Automate!

MORE INFORMATION

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THE FOREX REPORT

Analyzing statistical, econometric, and behavioral trends in the foreign exchange markets for insight into the optimal use of the FX Engines automated trading platform.

The information contained in this report is represented without warranty or any statement of its veracity. The contents of this report are intended to stimulate thinking on issues related to trading forex. This report does not suggest any particular action that could be utilized in live trading for profit or loss.

I can put it no better than Hoffer, who deferred to Montaigne:

“All I say is by way of discourse, and nothing by way of advice. I should not speak so boldly if it were my due to be believed.”