

TRADING INSIGHTS



WHO WINS : WHO LOSES

Some facts before trading



It is a given fact that very few traders make money, whether in the stock market or in commodities, whether in the cash market or in futures. However, those who do, make BIG money.

But, why do so many traders lose money?

What is the difference between successful traders and unsuccessful traders?

How does one help retail participants make money by trading?

Presented in this book are a few insights and rules that will help you succeed in trading.



Some caveats before starting

- Trading is a high risk, high return game. Retail participants are lured by the returns; forgetting the risk.
- Trading is a high involvement activity. One cannot be a passive trader. It is better to be a passive investor, not a passive trader.
- Trading requires skill, discipline and one needs to follow discipline without any emotions.
- Only discipline with a certain amount of skill can help you make money and not intelligence.
- Trading is nothing but a game of probability.

APPROACH TO TRADING



There are some simple rules to trading. Follow these rules sincerely and diligently and chances are you will avoid some of the mistakes that traders often make.



Allocation Strategy

- Clearly demarcate funds between Investment & Trading.
- Allocation for trading depends on **“Risk Bearing Capacity to lose money”**.
- Lower the risk appetite, lower the trading allocation.

Risk Bearing Capacity	% Allocation to Trading
Low	Up to 10%
Medium	10% - 25%
High	25%+



Investment or Trading?

At MOSL, we classify market participation into these broad categories, based on investment styles:

- **Investment** - Investment is placing money into an asset class (in this case equities) based on research & analysis on fundamental factors like sales turnover, net profit margins etc, with the expectation of gain over a short term (1year) medium term (3 years) or over long term (5 years or more).
- **Trading** - Trading is placing money in any asset class (in this case equities) for a shorter time horizon. Unlike Investing where a company's financials are researched, Trading involves taking buy and sell decisions based on news, technicals, short term outlook etc. Trading can be further classified into the following:
 - **Positional trading** - Positional trading is a speculative position taken in the markets for a time period of anything between 2 days to 3 months.
 - **Intraday trading** - Intraday trading is a speculative position taken in the markets for a single trading session (1 day). All trades are squared off on the same day at the end of trading session.

These are not watertight categories. Participants could be present in more than 1 category at any point of time.

Before entering any trade, be clear whether that trade is for Investment or Trading. If it is for Investment - then do not worry about short term fluctuations of the price. If it is for Trading, then use of Stop Loss and Trailing Stop Loss is a must.



STOP LOSS

Use Stop Loss & Trailing Stop Loss

- **Stop Loss:** Is a pre-determined price at which one will exit if the price moves adversely. Eg. If a stock is bought at ₹100 then ₹95 can be the Stop Loss. Below ₹95 the trader will exit the BUY position.

The following picture explains the concept of Stop Loss

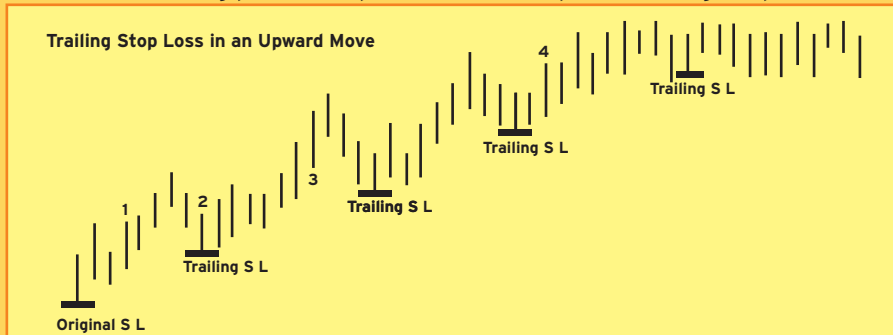


Types of Stop Loss



- **Trailing Stop Loss:** A situation where a trader continues to increase the Stop Loss to take advantage of any profitable trade. As price increases, the trader increases the Trailing Stop loss. Trailing Stop loss hit above his purchase price will be his profit.

The following picture explains the concept of Trailing Stop Loss





Types of Stop Loss

- **Intraday Stop Loss:** To square off position of all intraday transactions. No carry forward.
- **Stop Loss based on Price %:** A Stop Loss (SL) which is determined as a particular percentage of price of the stock. E.g. SL of 3% of price of stock. i.e. if the price is 100 the SL would be 97.
- **Time based Stop Loss:** A time based Stop Loss is placed with a view to achieve the result of a particular position based on the pre determined time frame. If a Stop Loss or target is not hit within the time frame, the trader exits from the position.
- **Stop Loss based on Technical Analysis:** This type of Stop Loss is placed by combining the analysis of various charts (such as daily & hourly chart) or stand alone charts.

Stop Loss + Risk Reward



The risk to reward ratio for any trade should be 1 (risk) : 2 (reward). The reward ratio can increase by use of Trailing Stop Loss.

As price increases the trader increases the Trailing Stop Loss. Trailing Stop loss hit above his purchase price will be his profit.

Why book a profit at ₹110 if the price can run up to ₹125 or ₹130 or even more?



Stop Loss + Risk Reward

Success Ratio	No. of times Stop Loss is hit	Total Loss @ ₹1 per trade	No. of times Profit is earned	Profit Earned @ ₹2 per trade	Net Position (in ₹)
40%	6	$6 \times 1 = 6$	4	$4 \times 2 = 8$	+2
50%	5	$5 \times 1 = 5$	5	$5 \times 2 = 10$	+5
60%	4	$4 \times 1 = 4$	6	$6 \times 2 = 12$	+8
70%	3	$3 \times 1 = 3$	7	$7 \times 2 = 14$	+11

This is a hypothetical example

With a reward risk ratio of 2:1, money can be made even if one is right 40% of the time.

Some Advantages of Stop Loss



- Stop Loss is an important part of trading discipline.
- For a trader, putting a Stop Loss is a must.
- Stop Loss costs nothing to implement.
- Allows decision making to be free from any emotional influences and emotional influences are most dangerous.
- It prevents a small loss from becoming a disastrously large one (when a position is going against you, it is best to cut your losses immediately).
- No need to monitor position continuously after putting Stop Loss, and it prevents the trader from watching stocks for an extended period of time.



The Flip Side

- Argument against Stop Loss - If you are unsure about the position, then why not just bite the bullet and sell instead of waiting for a decline to take you out of the trade?
- At times, Stop Loss gets activated by a short-term fluctuation in a stock's price.
- The price will hit the Stop Loss and then move in the intended direction.

Why putting Stop Loss is difficult?

- Simple things are most difficult to implement.
- There is an emotional aspect and human psychology at work: there is more pain in losing a rupee than earning one.
- Hence, losses are not booked when Stop Loss is hit and profits are taken quickly.

POSITION SIZING



Determine your position size

Amount of money at risk in a single trade sets the 'size of position'.

Determine how much money to lose in a single trade?

Particulars	No Leverage	Leverage Position
Initial Capital	500,000	500,000
Risk Appetite per Trade @ 1%	5,000	5,000
ASSUMPTIONS		
Buy Price	100	100
Stop Loss (SL)	95	95
Therefore, quantity of shares per trade (Risk appetite per trade divided by loss per share if SL is hit)	1,000	1,000
Position Value (Buy price per share X No. of shares)	100,000	100,000
Margin%	100%	25%
Capital Required	100,000	25,000
No. of positions that can be taken simultaneously with same parameters	5	20

This is a hypothetical example with a 1% capital risk appetite per trade.

Try the Position Size Calculator by typing the following link in your browser:

www.motilaloswal.com/MOSL/uploadedFiles/P.S.Calculator.xls



Therefore, to lose the whole amount (₹5 lacs), how many times do you have to go wrong continuously?

Capital Preservation : Strict Stop Loss

PARTICULARS	SCENARIOS			
	I	II	III	IV
Initial Capital	500,000	500,000	500,000	500,000
1st Trade	490,000	495,000	490,000	495,000
2nd Trade	480,000	490,000	480,200	490,050
3rd Trade	470,000	485,000	470,596	485,150
No of trades to lose capital	50	100	228	458

Scenarios Explained:

SCENARIOS	PARTICULARS
I	2% Loss of initial capital base
II	1% Loss of initial capital base
III	2% Loss of reduced capital base
IV	1% Loss of reduced capital base

This is a hypothetical example

Traders play both sides of the market



- A trader will have a long position if he feels the prices are going up (first buy and then sell).
- He will have to go short if he feels that prices will fall (first sell and then buy).

Most retail traders unfortunately do not go short or keep a Stop Loss and hence lose money when the market falls.



TECHNICAL ANALYSIS

What is it?

Technical Analysis is the study of market action primarily through the use of charts for the purpose of forecasting future trends - *John J Murphy*

Purpose

The purpose of Technical Analysis is not to be able to accurately identify each and every market position all the time. The real objective is to find trading opportunities that have a probability of success - *Robert Miner*

Basic Assumptions of Technical Analysis

- The Market discounts everything.
- Prices move in trends.
- History tends to repeat itself.

Benefits of Technical Analysis



- Helps to protect profits.
- Cut losses.
- Profit & Loss figures are known before entering the trade.
- Can trade on both sides of Market.
- Decision is out in short time.
- For short term trading, fundamental analysis is irrelevant.
- Known Stop Loss and Target helps to take quick corrective action.



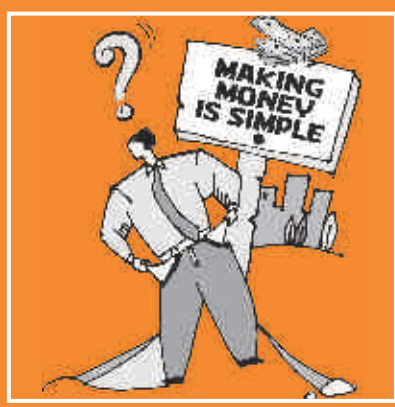
The Flip Side & Criticism of Technical Analysis

- Stop Loss may not be fixed scientifically.
- Frequent Stop Loss.
- Prices don't distinguish quality.
- You could be left holding third grade stocks just because it looks technically good.
- You could miss the big moves.

Criticisms

- Charts are great for predicting the past - *Peter Lynch*
- If past history was all that was the game, the richest people would be the librarians - *Warren Buffett*

If making money is so simple, why do people still make losses?



Because,

- Simple things are the most difficult to implement.
- There is an emotional aspect and human psychology at work; there is more pain in losing a rupee than earning one.
- Losses are not booked when Stop Loss is hit and profits are taken quickly.

Learnings

- Trading is a game of defense and not aggression.
- It is a game of patience and discipline.
- Decide your Trading Allocation.
- Decide whether order is for Investment or Trading before executing.
- Use the concept of Stop Loss and Trailing Stop Loss religiously.
- Have a risk to reward ratio of 1:2.
- Don't lose more than 1% of your capital in a single trade. Position Size is the key to success.
- Play both sides of the market.

Hope this note will help you trade better, reduce losses, preserve capital and make money!

Happy Trading



There are different MOSL Research products for different approaches. Take your pick.

RESEARCH PRODUCTS

Duration	Thematic	Sector	Company	Market Analysis
Regular	<ul style="list-style-type: none"> Expert Speak EcoScope Ground Reality Conferences / Events* <ul style="list-style-type: none"> Elections* Policy Maker 	<ul style="list-style-type: none"> Industry Update <ul style="list-style-type: none"> Travelog Wall of Worry 	<ul style="list-style-type: none"> Initiating Coverage* Company Updates* Re-initiating Coverage* <ul style="list-style-type: none"> Corner Office InSites 	
Yearly	<ul style="list-style-type: none"> Budget* Wealth Creation Study* 		<ul style="list-style-type: none"> Annual Report Update 	
Quarterly	<ul style="list-style-type: none"> India Strategy Report* 		<ul style="list-style-type: none"> Results Preview* Results Update / Review Holding Report 	
Monthly		<ul style="list-style-type: none"> mPower Auto Dashboard Tele Talk Time Indian Airports <ul style="list-style-type: none"> Ports Power Generation Gasoline 	<ul style="list-style-type: none"> AMC Holdings 	<ul style="list-style-type: none"> MOST Wealth* Derivatives Roll Over PMS Newsletter
Weekly		<ul style="list-style-type: none"> Metals Weekly 	<ul style="list-style-type: none"> MOST 3X3 Valuation Guide 	<ul style="list-style-type: none"> Commodity Weekly Weekly In Nutshell <ul style="list-style-type: none"> Pivots
Market hours				<ul style="list-style-type: none"> MOST Derivatives Daily <ul style="list-style-type: none"> Commodity Daily MOST Market Outlook MOST Market Roundup

* Also available in print copies

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NSE (Cash) : INB231041238; NSE (F&O) : INF231041238 ; BSE (Cash) : INB011041257; BSE(F&O) : INF011041257;

CDSL : IN-DP-CDSL-09-99 ; NSDL : IN-DP-NSDL-152-2000; AMFI : ARN 17397; *PMS : INP000000670;

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