

“The Four Questions”

As a trader, everything you do comes back to one of the four questions¹ that I'll cover in this research note.

Everything a trader does can be linked to trying to answer four questions

1. why am I getting into the market?
2. where am I getting into the market?
3. where's my stop?
4. where's my profit?

As a trader you should ask yourself these questions when you put on a trade. *Every trade.* After time it becomes second nature. But what else can these questions tell you? Well, they can tell you pretty much everything that has to do with trading. Let's break down each question and see what I mean.

Why am I getting into the market?

This is the reason we look at charts, read emails, newsletters, books etc. As traders we are looking for a reason to get into the market. Perhaps the reason is the top of a Bollinger Band? Or, there's

- a flying wedge formation on the chart?
- a trend line that's been touched/broken
- a signal from a stochastic which is oversold/bought
- a signal from the MACD which is oversold/bought or just crossed
- a head & shoulders formation

You get the idea.

When we take a candlestick class we're trying to answer question # 1. The same thing can be said when we read about how a Bollinger Band works, or if Fractals can be applied to the market. Any indicator can pay service to question #1.

As a trader we are continually investigating how different indicators work so we can have a reason to trade/answer question #1. And, indicators come in many different forms; whether it's watching trade flow, a chart, or some other indicator.

¹ “The Four Question” originated from the work of Byron Katie, who produced the great book *Loving What Is*.

This is the most basic concept in trading, answering the question ‘why am I getting into the market?’

Perhap:

- Swap spreads are narrowing and the cash 5yr breaking so you’re buying the 5yr cash.
- Every time you see consecutive 500 lots sold in the market, we break. So, you’re selling.
- The buying appears to be drying up, you’re selling.
- Repos are special, you’re buying.
- NFP is +180k and we were expecting +130k. You’re selling.

The list goes on. *The point is this:* there’s so much information coming at us that you need to ask yourself a question, “is this information paying service to answering question #1, 2, 3 or 4?”

Where am I getting into the market?

Ok, I’ve answered question #1, now what? Should you just enter your order *at-the-market*? Sometimes the answer to that question is no and sometimes yes. For instance, just because a MACD crossed isn’t a good reason to get into the market. Using an oscillator combined with the MACD is a much better method than just entering when a MACD crosses. (See [Research Note](#) (Indicators - Combining Them to Create a Trading Strategy (Class 1, 2, and 3))). [Password for the paper is 2112.]

If you are reading about oscillators, from a book, or a web site, or an article, then you’re paying service to answering question #2. Oscillators are one way to enter the market. I suggest you read about oscillators. Try this link,

<http://www.investopedia.com/articles/technical/070301.asp>

I have more links and I’d be happy to forward them to you. Email me,

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Perhaps you’re getting in ‘at-the-market’ because an economic release just came out and it was bearish/bullish. Or because you’re reading the order flow. The point being, even if you just read order flow and execute at-the-market, you are able to track what you do back to question #2. If you were reading about order flow, or economic numbers you’d be paying service to question #2.

Where is My Stop?

You should know the answer to this question as soon, if not sooner, than order entry. This is a major problem with many traders. Cure the problem and you’ll see a change in your PnL.

One of my favorite stop indicators is the Average True Range (ATR). (See, [Research Note \(Volatility; Interpret Vol to Your Time Frame\).pdf](#), or [Research Note \(The Average True Range\).pdf](#) [Password is 2112, for either paper].

The concept is simple. Stop equals the ATR, on entry, no matter what time frame you are trading. For example, I trade off of a 5 minute chart for Oil. The ATR is running about 15 boxes these days. (ATR is set to SIM, 10. That means it's a **simple** moving average set to look back 10-bars). The second I enter a trade I know my stop. All I have to do is look at the ATR.

What about trailing stops? This is the second thing you should look at after you look at ATRs. Learn about trailing stops. There's no reason why you can't take-a-few-off and let 1 or 2-lots trail. Go Google and search for "trailing stop order" and use the quotation marks. Those quote marks help narrow the search.

I used trailing stops for automated systems I built. Most trailing stop systems use a percent-of-entry to trail. Or, a dollar trail. Perhaps you could use an ATR trailing stop? There's an idea.

Again, here's *the point*: when you read about stop orders, you're paying service to answering question #3.

Where is My Profit?

Again, I love the ATR. I'll take half the ATR as a profit. Mathematically if I'm winning a certain percentage of the time I can take half the ATR and stop myself out using the whole ATR. Granted you must take extreme volatility into account but that's pretty easy, except for shock-and-awe. However, if I know my stop, even shock-and-awe shouldn't be a problem. *The secret is to stop trading after you have 2 losses and reassess question #1.* Go back and read that last sentence. It's key for many traders. Not all but many.

Conclusion

Instead of beating yourself up why not just reevaluate one of the 4 questions? It's probably question #1 that needs to be addressed. However, it could be any of the 4.

What method are you using to answer the question 'why am I getting into the market'? Bollinger Bands? MAs? Linear Regression? Order flow? It's not working and you need to ask yourself why and if you're still confident trading with that method, today.

The point: If you are reading about indicators, you are paying service to answering question #4.

Everything a trader does should be linked to answering one of the four questions. By practicing answering these questions the market will become less chaotic and I guarantee your stress level will drop. Bad habits will go away and you'll increase your PnL either by taking smaller losses or bigger winners.

Thank you,
Jim Goulding