Investing to Win

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15 July 2017

Can you make money with random entries? If you use good exits and position size, then YES, you can! The **most** important elements of successful trading are position sizing and exit discipline.

What follows is an excerpt from *Trade Your Way to Financial Freedom*, 2nd Edition, by Dr. Van Tharp.

> I was doing a seminar with Tom Basso (see his sections in Chapters 3 and 5) in 1991. Tom was explaining that the most important part of his system was his exits and his position-sizing algorithms. As a result, one member of the audience remarked, "From what you are saying it sounds like you could make money consistently with a random entry as long as you have good exits and size your positions intelligently."
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> Tom responded that he probably could. He promptly returned to his office and tested his own system of exits and position sizing with a "coin flip"-type entry. In other words, his system simulated trading four different markets and he was always in the market, either long or short, based upon a random signal. As soon as he got an exit signal, he'd reenter the market again based upon the random signal. Tom's results showed that he made money consistently, even using $100 per contract for slippage and commissions.
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> We subsequently duplicated those results with more markets. I published them in one of my newsletters and gave several talks on them. Our system was very simple. We determined the volatility of the market by a lo-day exponential moving average of the average true range. Our initial stop was three times that volatility reading. Once entry occurred by a coin flip, the same three-times-volatility stop was trailed from the close. However, the stop could only move in our favor. Thus, the stop moved closer whenever the markets moved in our favor or whenever volatility shrank. We also used a 1 percent risk model for our position-sizing system, as described in Chapter 12.
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> That's it! That's all there was to the system-a random entry, plus a trailing stop that was three times the volatility, plus a 1 percent risk algorithm to size positions. We ran it on 10 markets. And it was always in each market, either long or short, depending upon a coin flip. It's a good illustration of how simplicity works in system development.
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> Whenever you run a random entry system, you get different results. This system made money on 80 percent of the runs when it only traded one contract per futures market. It made money 100 percent of the time when a simple 1 percent risk money management system was added. That's pretty impressive. The system had a reliability level of 38 percent, which is about average for a trend-following system.

The point here is this: It is a waste of time to agonize over your entries.

1. Find a security that looks promising.
2. Decide how you will know the investment is not working. That's your emergency exit.
3. Check for red flags (i.e., see if there are any reasons not to buy it).
4. Figure out how many shares or contracts you should buy. Then cut that number in half.
5. If there isn't any reason not to buy it, then buy a small position.

Laurent Bernut is a professional trader who manages over a billion dollars on a regular basis. He sums it up this way, "Focusing on the entry keeps people addicted to failure."