AXIORY

Master The Markets: Forex, Indices, and Stocks

Trade
Better
Together

Foreword

This is an impressive project because it tackles a complex topic and distills years of professional experience into a highly readable and approachable book.

It captures the classic education that someone would receive when joining an investment bank or hedge fund trading desk, preparing to take discretionary risk.

All the major topics are dealt with - risk management, fundamental and technical analysis, psychology - and the guidance is simple, realistic and helpful.

This is a beginners' book for serious traders, written by a professional in the industry. For those interested in trading and without an investment banking or hedge fund background, it would be an excellent place to start.

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Master The Markets:
Forex, Indices, and Stocks

Edition 2.0

Content

Introduction

If you have bought this book it is probably because you are looking to learn about or improve at trading. Most likely in Forex or indices or single stocks. That's great. However, we have to get one thing out of the way first. Trading is not a get-rich-quick scheme.

If you have seen an Instagram post, promoting the idea that you can 'get rich quick' with zero effort, then I'm afraid that is simply not true. Things that are too good to be true, usually are not true.

Despite some of the things you see online, trading is not a license to print money with little or no work required. Trading can be enormously interesting and intellectually stimulating. Trading can be a great full-time career. Many folks have become extremely well off, even billionaires, from trading. However, trading is not easy.

Like any game of skill, trading requires mastery and that takes time and effort. To be clear: do not start trading if you think it is a get-rich-quick scheme. With this crucial health warning out of the way let's look at why we wrote this guide and what you can hope to get out of it.

The Difference Between Amateur and Professional Results

The difference between how trading is conducted by the pros and the retail trader is simply huge. It shows in the results. The overwhelming majority of retail traders lose money.

FIGURE 1
Source: data from regulatory filings analysed by Finance Magnates

This is not the case for professionals. Bank traders' true PNL is masked because they have client franchises. However, currency funds do report their PNL and it is generally pretty good. The below is from EurekaHedge and shows the performance of their index of 20 Forex hedge funds.

Statistics (as at Sep 2019)	
Annualised Return(%)	7.21
2019 Return(%)	3.47
2018 Return(%)	-0.23
Last 3 Months(%)	3.11
Return Since Inception(%)	295.19
Best Monthly Return(%)	6.35
Worst Monthly Return(%)	-1.70

FIGURE 2
Source: data from EurekaHedge website

The reason for the difference in performance is not that the pros are much smarter than the average retail trader. It is because they have been trained to take disciplined, logical approaches to trading. They use specific tools and techniques to help them achieve this.

I should know. My first graduate job was trading Forex at an investment bank that was then the third-largest currency trader in the world.

Like any new trader, I had a steep learning curve and plenty of challenges. However, I had the huge benefit of being trained by some of the best in the market. Each day I saw how professionals with long track records of successful PNL approached this business. I picked up things mainly by getting it wrong and asking questions.

During this course, you are going to learn the tools and techniques I learned.

The Jigsaw Method

I want to be clear about one thing. No one - this book included - can teach you a system or method that you can copy out-of-the-box and will produce instant results.

It does not work that way. If it was that easy everyone would do it. You have to experiment and find what works for you. Find what suits your personality and trading style.

The best approach is to have a broad appreciation of all the key topics that have been learned the hard way over decades of other people's trading experience. Other traders had to sweat and lose money to find out this stuff. The smart thing we can all do is learn from collective experience.

With full knowledge of these tools and techniques, you can then focus on the specific techniques that work for your style and personality. This book advocates the 'jigsaw method': learn about everything, try a little bit of everything, and then double-down on whatever works for you combining techniques and tools from different disciplines.

By the end of this course you will have a decent grounding in all the topics this book considers key to a trader's education. You will know more than 99% of retail traders I have met. However you will still be learning with each trade because the hardest thing in trading is not knowledge but psychology.

It is extremely tough to evolve your emotional reactions and thinking process. Staying rational on a trade to which you are emotionally attached. Taking a loss with the same level of emotion as you do a win. You can know exactly what to do and it still is not easy to do it.

What We'll Cover

Let's look at the topics we are going to cover together.

The Basics
The first two chapters are introductions.

First we are going to learn a little bit about market history. How the forex, and equities markets grew into what they are today.

Next we are going to examine some trading 101. We are going to look at topics you may have heard of like 'liquidity' and explain simply what all the jargon like 'pip' and 'spread' and 'bullish' and 'bearish' mean in simple terms.

This book is jam-packed full of examples so you can follow along in your own time. You'll learn how to calculate PNL as well as how all the order types work like 'stop loss' and 'take profit'. You'll also learn about two crucial topics for retail-trading: margin and leverage.

The Markets
After this we'll take a walk through the big speculative markets - forex and equities - and consider the role of various players. How do hedge funds, commercial banks, central banks interact with the market? How about the retail trading community?

Knowing who else is out there and how they use the market is crucial to trading survival. We are going to cover all the various instruments. Each trading instrument has a different 'personality' even currencies like AUD and EUR behave and trade differently, let alone compared with a stock like Tesla.

FIGURE 3
An illustration of a mobile trading app, which is a popular way to access the markets nowadays

Chart Wizards

Now that we know a bit about each market it is time to look at how to study price charts. This is a big chapter: technical analysis. This is the most common trade entry toolkit for retail traders. Technical analysis is very important but only one of several tools. We will cover the key topics such as support and resistance, moving averages, and candlesticks. Everything will be explained clearly with visuals and examples so you can follow along - even if this is completely new to you.

Risk Management

After that we will learn about risk management: position sizing, correlation, stop losses and risk reward ratios amongst many other tools. This is probably the single most important part of the entire course and what really separates professionals from amateurs.

	20%	30%	40%	50%
1:1	Not Profitable	Not Profitable	Not Profitable	Break Even
2:1	Not Profitable	Not Profitable	Profitable	Profitable
3:1	Not Profitable	Profitable	Profitable	Profitable
4:1	Break Even	Profitable	Profitable	Profitable

FIGURE 4
The concept of risk-reward will become second-nature

The Mind Game
Behavioural finance is next on our list. This is a fashionable subject these days. We are going to look at cognitive biases such as loss aversion, anchoring, confirmation bias and examine how they affect us all as humans and as traders. We will look at ways to help protect ourselves from emotions and natural bias, including writing a trading journal. We will also examine two crucial inputs to trading decisions: market positioning and market sentiment.

Connecting Multiple Markets
Intermarket trade ideas are another tool used extensively by the pros but rarely, if at all, by retail traders. We are going to look at the lead-lag relationship between instruments like oil and the Canadian dollar (CAD). You are going to start to think about trades in terms of relative value and this could open up many more high conviction trading opportunities. We will also run through some advanced charting techniques with examples so you can follow along.

News Trading
Next up we will cover the economic calendar. We'll go through an example of how to read it as well as highlighting some of the biggest events. We will look for the first time at trade entry ideas and how to use news and the economic calendar to generate trade ideas. You will learn about second-order thinking and start to think critically about what is priced into markets rather than simply reacting to news as it arrives.

The Magic of Factors
Factor-based trade ideas are our next idea generation chapter. You will explore the concept of momentum - probably the most famous of all trading concepts and the backbone of most technical analysis techniques. We will also look at another famous factor, which is the 'carry' factor that is so extensively used to trade the Japanese Yen (JPY).

The Fundamentals of Trading
It will then be time to cover the fundamentals of currencies and equity markets. This stuff is almost entirely ignored by retail traders but absolutely crucial for professional traders. Even if you do not trade fundamentally you need to have a basic understanding of the drivers of each market because the biggest players in the market trade off fundamentals and their trading activity will affect everyone's market price. This is where the big trends can be spotted early.

Real-world Trading
In the next chapter we'll put everything we've learned into practice. We will look at eleven trades (some winning and some losing) and see what went right and wrong in each case. The idea is to help you learn from your trading journal and give you the toolkit to analyse past trades - either by yourself or with a friend or mentor.

More Chart Wizardry
Finally, some more technical analysis. There was simply too much to fit into a single chapter. We will look at popular methods like Bollinger Bands, MACD and Elliott Wave Theory.

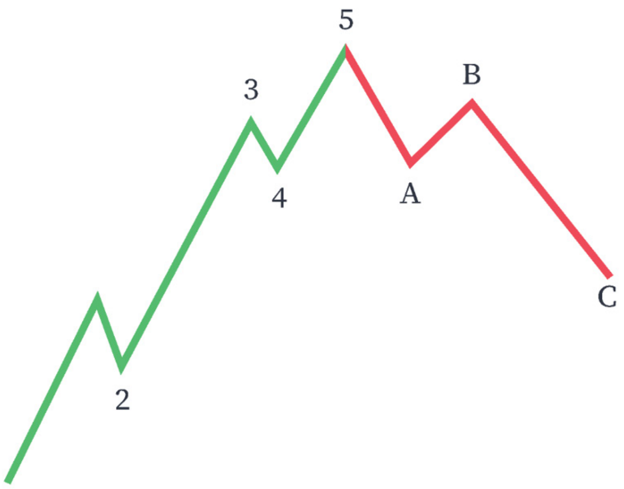

FIGURE 5
You will learn about the Elliott Wave Theory and other exotic-sounding techniques within technical analysis

01

A Brief History of Trading

In one form or another people have traded since the earliest civilisations. However, we are not interested in barter agreements. We are interested in the business of speculative trading. Buying something because you believe the market is going up.

In this chapter we'll walk you through how two major markets came into being. On one level, a lot has changed. There were no mobiles in 15th Century Florence. However, in many respects, nothing has really changed.

The emotions that a Florentine merchant - or a 1930s American stock broker felt when watching his position in the market were surely no different to what we all feel today. Trading was then and remains now a battle of wits. An exciting intellectual challenge.

Forex

Forex is one of the oldest markets because it is necessary for all sorts of real-world trade. When the Medici banking family were buying and selling textiles across the world in the 15th century they were also trading Florins. Florins being gold coins used in the European trading hub of Florence.

Gold remained important in the development of currencies. In the early 1800s countries like England and the United States adopted a gold standard. This means that anyone bearing the US dollar or British pound had the right to convert these currencies into a fixed amount of gold.

This creates high confidence in the currency.

In 1971 Richard Nixon addressed the nation, announcing the end of the gold standard. This meant the US dollar's value could 'float' i.e. go up and down based on demand. By 1973 most other major currencies had followed suit and forex trading as we know it began.

Now currencies could go up or down against one another based on the market's view of their relative strength. Fast forward to the 1980s and the interdealer era began.

This will seem completely 'old school' to you but this is the first time the markets vaguely resembled their current form.

Trading occurred between banks on the phone. It was hectic. Banks would employ teams of traders to do 'call outs'. Imagine a big hedge-fund buys 100 million Dollar-Mark (the precursor to EURUSD). The bank's chief dealer would tell ten of his traders to each call a bank and get a price in 10 million. When all the prices were in they would shout "mine" to signify that they'd bought the 10 million from each bank.

This was a chaotic and exciting time. Traders smoked in the dealing room whilst working.

Hedge funds and banks could speculate on the direction of each pair but the market was not readily accessible to the average person.

The next major shift was when the markets became electronic in the early 2000s. The two major Forex trading markets – Reuters and EBS – permitted computers to plug into their venues. For the first time computers could trade with humans ... or with other computers.

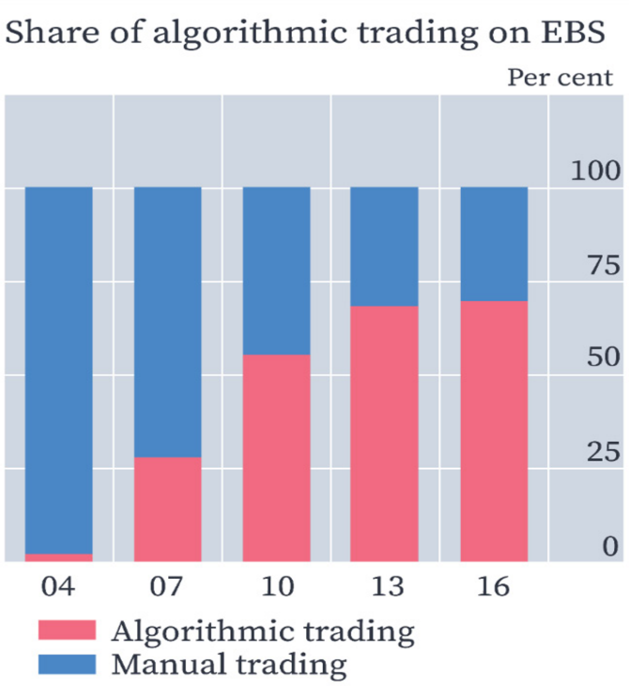

FIGURE 6
BIS data capture the migration to electronic trading

Banks began to offer their clients sponsored access to these venues. All of a sudden other players could join in. This democratised access and today the vast majority of Forex trading is electronic as you can see from below.

As markets became electronic, early retail pioneers were able to plug into the market (via dealer banks) and offer their clients fully automated execution.

Nowadays it is trivial for an average Joe to trade EURUSD from his couch or chart the price of the Chinese Yuan vs the US dollar with a click. In fact, almost half of all retail trading occurs on a mobile, according to the annual reports of various retail brokers.

The nature of the market has changed hugely from Renaissance Florence. However, the merchants of the day were doing something not totally unlike you.

Equities

Trading shares in companies goes back a long way. The Amsterdam Stock Exchange, depicted below, was the first stock exchange to launch continuous trading. Trading had long since been occurring in the famous Amsterdam coffee shops.

It took a long time for America to catch up. In 1792 the historic 'Buttonwood Agreement' was commenced. It is said that the 24 stockbrokers agreed on some rules of trading outside 68 Wall Street and this was the predecessor to the New York Stock Exchange.

When you think of the New York Stock Exchange you will likely be imagining the opening or closing bell as seen on CNBC and other business channels. However, trading is nearly entirely electronic and not all of it takes place on exchanges.

One of the best books on trading ever written was Reminiscences of a Stock Operator. I highly recommend you read it. Written in 1923 it tells the story of a 'plunger'. That is a man who plays the stock market.

He makes a fortune, loses it, and makes it back. He bets on important companies of the time such as the railways and often uses trading tactics that would be illegal today. However, the core concepts of greed and fear and reading the prices and trends have not changed one bit.

Originally all trading took place against 'specialists'. Specialists were traders, members of the Stock Exchange, who provided prices for others to buy and sell an instrument. Each specialist would cover five or ten stocks and had a little monopoly on these. There were many complaints about the specialists. They were said to have abused their position of power. In 1984 NASDAQ launched the SOES (Small Order Execution System). This forced the specialists to display their quotes electronically and more importantly honour them in up to 1,000 shares.

FIGURE 8
'FANG' tech stocks have captured the imagination of investors in the last decade

That meant retail investors could suddenly see and access the real orderbook. This system was exploited by what came to be known as the SOES bandits.

SOES bandits would monitor the stock prices on various systems, understanding that one might update to incorporate some news before a specialist could update his or her terminal. If a price was off then they would whack it. Soon SOES bandits became responsible for 13% of overall order execution.

Wall Street professionals hated this of course. However, it provided the impetus for developing the fully electronic trading that we see today.

Today a retail investor can trade shares at a click of a button. Often at better prices than are available on the public markets and in recent years with zero commissions.

This is made possible because the market makers who provide prices really like the small-size retail flow and will pay retail brokers to send it to them. Instead of hedging it on the market they will sit on this risk and wait for another retail trade to take the other side and flatten them out.

As trading equities has become cheap and easy, volumes have exploded and companies have been born.

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this sample?

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