Hanover posts wisdom

https://www.forexfactory.com/showthread.php?p=2444822#post2444822

This must be about the 99th time I've posted this type of message.
It's addressed to all of those well-meaning folk who believe that:

-- you can succeed in forex with MM and discipline **alone**
-- the system doesn't matter; it's all about the trader, his mindset, and his mastery of self
-- it's possible to profit in the long term by using random entries
-- trading psychology books (like Mark Douglas'), and/or clichés posted on forums, tell you most of what you need to know

Consider this:

An EA will trade according to strict MM rules, and with perfect discipline. Writing an EA that "*enters every emerging move, cuts losses short, lets profits run, and risks only 1% (or 2%) of your account per trade*" is a very simple algorithm to program. An EA will trade 24/7, executing a plan flawlessly, consistently, tirelessly, emotionlessly. It removes the trader, his mindset, and any lack of self-mastery, from the equation altogether. An EA automatically guarantees all of the following: Adherence to strict MM rules. Perfect accuracy of execution. Endless patience. Unwavering discipline. No fear, greed or hesitation. Immunity from hunches, guesswork or outside 'noise'. Around-the-clock trading that's unaffected by tiredness, illness, stress, negative attitudes. No data entry errors. Much more recreational time for the trader, away from his PC.

But I think it's fairly obvious that, if long-term profit was this easily attainable, then everybody would own such an EA, and we'd all be forex millionaires.

So here's my point: If MM and discipline are all that's needed, and an EA addresses them perfectly, why do the vast majority of EAs ultimately fail? The answer is much the same reason why 95% (or whatever the number is) of traders do likewise. Their 'market knowledge' of how, when – and possibly why – prices move, simply isn't good enough. Their analysis isn't intelligent or accurate enough to locate 'on-balance' profitable price patterns, cycles, or behavior that's potentially robust enough to last a lifetime. Or, failing that, they're not smart enough to periodically evaluate whether such an inefficiency is still operating as profitably as it did previously, and if necessary adapt accordingly. Knowledge, analysis, inefficiencies, forecasting, adaptability…. these all relate to **entries**, and apply irrespective of whether an approach is 'discretionary' or automated.

Heck, if entry is completely unimportant, then why bother with any kind of analysis? Why look at price charts at all? (now that's **really** trading naked, LOL) Why study averages, or economic trends? The big funds could save themselves millions in salaries by dismissing all of their analysts, and running primitive EAs along the lines of the one that I described.

Yes, it's true that reckless MM and indiscipline will deplete an account much more quickly than an ineffectual method, and *may therefore mask the latter*. But the fact is that, without some kind of methodological edge, you must also eventually fail. Costs make forex a negative sum game.

And it's true that exiting losing trades quickly, and letting winning trades bloom, is an essential component of many profitable trading approaches. But effective only if combined with an entry that gets you in on the right side of a move frequently enough to tip expectancy in your favor. Many are fooled by the idea that price moves 50/50, and therefore believe they're assured a 50% win rate, even if they make trades with an R-value > 1. But the fact is, everything else

being equal, the higher the R-value, the lower the win rate; the two are inversely proportional to each other. For an exit method to be effective in its own right, then, it must somehow overcome this inherent equilibrium.

Making random entries means trading against the 'trend' 50% of the time. It means completely ignoring support and resistance, momentum, rejection, volatility, correlation, statistical deviation, session considerations, economic influences and drivers, news announcements.

I'd be delighted to be proved wrong. I wish it were possible to succeed without the need to have a strategy, because it means that I could easily write such an EA, and then effortlessly become a forex millionaire myself.

So, to answer the original question as to what is most important, here's my two cents worth:
Superior analysis and forecasting. Exploiting inefficiencies. Effective entries. A methodological edge.

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The following refers to the diagram below.

If price takes either path "1" or path "2", Trader "X" will be 20 pips better off than Trader "Y", and 2x20 pips better off than Trader "Z". Provided that all 3 traders ultimately exit at the same point, then **that will always be the case**, regardless of where the exit point is (in profit or in loss). In both of these scenarios, and everything else being equal, X (who entered his entire position at A) will outperform Y (who scaled in).

But everything is not necessarily equal; we must take the probabilities into account. If upon reaching level B, the probability of outcome "1" is significantly greater than outcome "2", than it was at A, then "Z", who has weighted his position more heavily at "B" will fare best, and "X" worst. No matter

what the outcome, Y's performance will always lie somewhere between X's and Z's, because he has hedged his bets. Scaling in is a form of diversification.

However, if price takes path "3", then it depends on the exit point. If the exit point is higher than A, then X will outperform Y, and both will outperform Z, who never managed to enter. However, if the exit point is below A, then Z comes off best (no loss), while Y's loss is only half of X's. And so on.

Of course we can't calculate the probabilities like we could with, for example, Poker or Roulette. But if we tested the idea over a very large number of trades, we'd get a rough idea. That's what I meant by "prove or disprove". Hence **I'm not saying that pyramiding can't work**, just that you'd need to run appropriate tests (within the context of your entry/exit rules). If you've already proved that to yourself, then great! Nobody can argue against profit and success. 😊

Of course the scenario is an oversimplification. We could have additional entry points (C, D, …), and apply different methods of exit (e.g. trailing SL). But no matter how complex the scenario, the same principles apply in much the same way.

About position sizing. If you put higher bets on higher probability outcomes, you will win more. But simply putting higher bets on without taking probability into account will result in larger wins, and larger losses, in the same proportion. If the probability of trend continuation (outcome "1") is sufficiently greater at B than it is at A, then you'd be justified in buying more lots at B than at A. But that's only because the probabilities justify it; the position sizing **by itself** doesn't create an edge..... but, used judiciously, it can magnify (or diminish) the dollar value of an existing edge.

Probabilities would likely vary, depending on the location of A and B, i.e. if they were at key price levels (S/R, pivots, Fibo retracements, round numbers, etc). But again, that's related to

entry methodology, rather than position size.

Likewise, psychology by itself can't create an edge. An EA will trade with perfect discipline, but simply running an EA doesn't guarantee that you will be profitable. In fact the opposite is true; I posted on this topic here. If simply pyramiding into every emerging trend created an obvious edge, then everybody would use such an EA, and become a forex millionaire. But apparently this doesn't happen.

https://www.forexfactory.com/showthread.php?p=3719674#post3719674

So you double 5 times. If the fifth trade loses, you are down 1+2+4+8+16 = 31 units. So here are your choices:

a) Cut your losses, and revert back to a position size of 1 unit. Now you have to make a sequence of 31 wins to compensate for 5 prior losses; OR

b) Double again, and risk being down 31+32 = 63 units, but at least it will only take 1 win to compensate for the 5 losses. But if you keep doubling with each loss, it will only take one sufficiently long losing streak to blow your account.

Increasing position size to recover losses is gambling. No position sizing method can give your trading an edge. Only a solid knowledge of how markets operate, and fashioning a suitable method of entries and exits around that knowledge, can ever achieve that.

Having said that, there's no law against using forex as a vehicle for gambling. But you need to decide carefully what kind of risks you're willing to take. It's a personal decision.

FWIW, I posted about Martingale in more detail here.

Re which pairs, Martingale is a betting (sizing) strategy, not a trading strategy, so it makes no difference. You **might** use different entry and exit strategies to exploit different price behavior in different pairs, but that has nothing to do with sizing.

The smaller your starting size relative to your total capital, the more doubles your account will survive. But you're crippling your returns exponentially. As a **VERY ROUGH** example:

Trader 'A': account = $10,000. Starting lot size = **0.01**. One trade per day, profit taken at 10 pips. Annual return = $1 per day x 250 trading days per year = a **2.5% return** on a $10,000 account. Starting risk per trade = 10 pips = $1. Hence the account can survive 1+2+4+8+16+32+64+128+256+512+1024+2048=$4095, i.e. 12 consecutive losses. The probability of 12 consecutive losses, within any 250 trade sequence, with a 40% win rate**, is **41%** (see the attached table).

Trader 'B': account = $10,000. Starting lot size = **0.1**. One trade per day, profit taken at 10 pips. Annual return = $10 per day x 250 trading days per year = a **25% return** on a $10,000 account.Starting risk per trade = 10 pips = $10. Hence the account can survive 10+20+40+80+160+320+640+1280+2560=$5110, i.e. 9 consecutive losses.
The probability of 9 consecutive losses, within any 250 trade sequence, with a 40% win rate, is **91%**

[** Let's assume that the win rates of both traders is 40% (for scalping 10 pip moves, for example, it will be somewhat less than 50%, due to the spread).]

Do you think that either of these equations represents

acceptable equation?
-- 2.5% annual return, with a 41% probability of irretrievable drawdown in the first year
-- 25% annual return, with a 91% probability of irretrievable drawdown in the first year

Put another way, is it worth crippling returns by 10 times, when the risk of ruin is only a little more than doubled?

Of course, these figures are a **rough guide** only, and they assume 10 pip scalping, no real entry/exit strategy, 1 trade per day, no compounding of wins/losses, etc. But hopefully they illustrate the kind of thinking you need to undertake before you put money on the line.

Footnote: values in the table are rounded to the nearest whole percent. Hence the yellow areas mean > 99.5% and < 0.5% respectively. The calculation assumes that there is no causal link between trades, i.e. that each trade is an 'independent' event.

	Probability of X consecutive losing trades within a 250 trade sequence									
Win rate	3	4	5	6	7	8	9	10	11	12
5%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
10%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
15%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
20%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
25%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
30%	100%	100%	100%	100%	100%	100%	100%	100%	99%	96%
35%	100%	100%	100%	100%	100%	100%	99%	96%	88%	74%
40%	100%	100%	100%	100%	100%	98%	91%	77%	58%	41%
45%	100%	100%	100%	100%	98%	87%	67%	46%	28%	17%
50%	100%	100%	100%	98%	85%	61%	38%	21%	11%	6%
55%	100%	100%	99%	87%	60%	34%	17%	8%	4%	2%
60%	100%	100%	92%	63%	33%	15%	6%	2%	1%	0%
65%	100%	98%	73%	36%	15%	5%	2%	1%	0%	0%
70%	100%	87%	45%	16%	5%	2%	0%	0%	0%	0%
75%	98%	62%	21%	6%	1%	0%	0%	0%	0%	0%
80%	86%	33%	8%	2%	0%	0%	0%	0%	0%	0%
85%	57%	12%	2%	0%	0%	0%	0%	0%	0%	0%
90%	22%	2%	0%	0%	0%	0%	0%	0%	0%	0%
95%	3%	0%	0%	0%	0%	0%	0%	0%	0%	0%

https://www.forexfactory.com/showthread.php?p=3719963#post3719963

What you're describing is a type of 'pyramiding' rather than Martingale. The answer is that success will depend on how well you're able to pick trends, and (as with all methods) how accurately you adjust your position (or in this case, add positions) relative to price reversals.

A pyramid is nothing more than a group of individual component trades. Each of these trades needs to be on-balance profitable **in its own right**, otherwise it is undermining overall bottom line. Simply adding positions on the basis that the existing trade is in profit won't work **in itself**. If a pyramiding method is on-balance profitable, that is because of the way in which it's exploiting the trending nature of the market, not because of the MM. The proof lies in the fact that if price was a completely random walk, EVERY method would have an expectancy of zero. Hence the success of any method ultimately depends on how accurately it exploits inefficiencies in price behavior.

I included some specific examples of the rationale behind 'pyramiding' in my post here.

https://www.forexfactory.com/showthread.php?p=3116534#post3116534

No betting system, including Martingale, offers any advantage in expectancy over flat betting, over any number of trials (trades). Prove the laws of math wrong, by using the attached XLS. Go on, you know you want to! Type any combo of values into the yellow cells that result in the gray cell (AK8) having a non-zero value, and re-post the XLS here. Then ready yourself to accept the relevant Nobel prize. (all assuming there are no

bugs in the XLS formulae 🙏)

Let's apply some common sense. If it were possible to gain any kind of edge at roulette by varying bet size, everybody would go down that path, and casinos would be forced to change the game mechanics. It's not just the table limits that restrain you. Sure, they're there to protect the casino against a freakishly lucky punter, but even without those limits Gambler's ruin (en.wikipedia.org/wiki/Gambler's_ruin) would ensure that virtually every punter who doubles up repeatedly will end up bankrupt long before the casino does.

Similarly, if it were possible to win at forex by using MM (i.e. varying position size or method) **alone**, then surely every trader would go down that path, and become a millionaire. The 'willing-buyer, willing-seller' and zero sum game constraints provide proof that this is an impossibility.

Averaging down will give you +EV to whatever extent the probability of price reverting to a mean improves, the further it trends away. Increasing one's bet size as probabilities improve is **smart** (ask any Blackjack pro). But increasing one's exposure **without limit** is guaranteed to eventually result in irretrievable drawdown.

Here's the rub. Let's say we average down, doubling our pos size every 10 pips. If price moves 80 pips against us, that's 1+2+4+8+16+32+64+128 = 255 units at risk. So we need odds of 255 to 1 **in our favor** that price will reverse 10 pips, before it falls another 10, to justify that bet size. **The problem is that our bet size is based on our desired account balance, and is no longer commensurate with the probability that's being offered by the market.**

And let's not forget that costs must be overcome. With a 2 pip spread, you'd need price to move 12 pips in your favor (TP) before it moves 8 pips against you (SL).

Ironically, Martingale guarantees a 100% win rate, until you lose everything. The only consolation is that the losing sequence that causes the 'death trade' **might** not happen during your lifetime. Irony #2 is that the longer you live, and the more often you trade, the greater the probability that you'll encounter it. There might be several hundred chambers in the gun, but you never know which one holds the bullet. Maybe it won't happen until the year 2030. Or maybe it will happen next week.

There are lots of ways to mitigate the effect of the Martingale:

1. You can use a less severe betting progression (e.g. Fibonacci steps, d'Alembert, etc), but then it takes more than 1 win to return to breakeven, i.e. you cripple your recovery rate. You need multiple wins without intervening losses, making recovery more difficult. So you're effectively offsetting one type of risk with another.

2. You can start with a nanolot pos size, but then your return is reduced in proportion with the risk. Not much point in having a $10k account and winning only 10 cents per trade. (Then, after (say) 10 losses, having to risk $204.80 just to make 10c!)

3. You can cut your losses and start over, e.g. after 5 losses, but then you're back to sizing at 1 unit, so you'll need 1+2+4+8+16 = **31 consecutive wins just to recover to breakeven**. Or after 6 losses, you'll need 63 consecutive wins. And so on. Just another way of crippling the recovery rate.

4. You can withdraw winnings from the account periodically, but in doing so, there's less funds there to provide a buffer against a prolonged losing streak, thereby increasing the probability of a margin call. And there's no guarantee that you'll make the withdrawal before the death trade occurs.

The conclusion is: **In any activity that involves**

uncertainty, return is always somehow commensurate with risk. To assure a 99.99999% win rate, you have to take an 0.00001% risk of losing everything. The innate, perfectly balanced equilibrium ensures that there's no exploitable loophole, no free lunch.

Anybody can get lucky in the short term. And maybe more than once. But I assume that most folk here aspire to be traders rather than gamblers. Having said that, there's no law against using forex as a vehicle to gamble, and with more leverage than any casino will ever offer you, should you choose to. Good luck!