Chapter 24 Finally, the First Step: Having a Plan

Tying everything in this book together will be making a trading plan. This should include what markets to trade, what strategies and time frames to trade, how to exit, your money management parameters, and how you review it. My best suggestion is that you make believe you have to report to a boss or investors that you will have to account to. They will want to see a review of your performance, how you justify your risks, and an explanation for why you did or didn't do what you did. The bottom line is without a plan you are just making random trades.

Having a Plan of Attack

Make sure to write your trading plan with as much detail as possible to guide you along the way, even before you start trading. You should have all your goals, strategies, entry and exits, risk parameters and so forth defined first before heading into trading full force. Of course it will be difficult to make a detailed trading plan with strategies until you have actually been trading a while, but it's never too early to put down what you do know. Your early days of trading will be part of your 10,000 hours, of which you will make many mistakes along the way. It's important to learn from these mistakes and incorporate these lessons into your trading plan. As you grow as a trader your plan should evolve with you.

Once you have a plan it is useless unless you can actually follow it and not let your emotions dictate how you trade. Review your performance on a regular basis to make adjustments as needed, and don't forget to report to your imaginary boss, spouse, or mom who wants to know why aren't you out looking for a job or when will you move out of the basement.

Making High Probability Trades

Only when having a plan can you ask yourself, "is this a high probability trade? Does the trade meet all my criteria? Does it stay within my max loss level, does it meet my risk/reward/POP expectancies, and do I know how much I am looking to make or lose on it? Is the IV at the right level for the trade? Does it make me too bullish? Or too sector heavy? What's the best strategy best for the current market conditions, am I using the right expirations? Are the strikes optimal?" Having a plan will help you identify potentail good trades as well as weed out the ones you shouldn't even consider. It makes sure every trade is put on with a reason and within your parameters.

FOMO & YOLO

These are two terms that don't belong in trading and can be prevented by sticking to a plan that can keep you on course. FOMO can be broken down into 3 things, the fear of missing out on a good trade, the fear of not capturing every last cent of a trade and the fear that if you get out of a loser, the market will reverse two minutes later, (it may seem like it usually does, but as long as it was the right thing to do, you need to learn to say "So What" and move on to next trade). Though this book is not about technical analysis one of the worst things you can do is rush into a stock that is on a tear, paying too much for it. It's much better to wait for the pullback to get in. I can't imagine how many times I watch CNBC and a commentator mentions a not too common stock, I will look at a chart and see it is spiking up as viewers rush into it fearing they will miss it, but 10 minutes later it retreats to where it was. If you do miss something there will always be another chance, if not, there will be other trades to make instead.

Then there are self-proclaimed not-too-bright traders on Reddit's WallStreetBets who post "Buying 10 Delta calls with 3 days to go and a 200% implied volatility, YOLO". Then post a picture of how they blew out their account a week later. This is not a smart tactic, even if they do get lucky once or twice.

Stay away from the win-big-or-die type of bets as slow and steady is the best way to succeed in trading. Take your time and follow a plan to keep you from making dumb decisions.

KEEPS YOUR EMOTIONS OUT OF IT

If you have a plan in place you may be less tempted by emotions, of which there will be many. Emotions can be the downfall of any trader, and at the very least, will keep you from following a plan and will lower your bottom line. Much of trading today is done by computers who do not have to deal with second guessing and emotions. Traders should try and do the same. Here are a few emotions you may want to keep in check.

Greed: Greed can hurt you several ways, but by setting exit and risk parameters you can limit greed driven mistakes. The desire to make too much money will lead you to putting on too many trades, taking on too risk, and not getting out when you should. Here are some examples:

1. Trying to capture too much of a trade, even when the trade tells you “that was a good one, let’s move on,” as when the max profit is $200 and you refuse to get out at $150 profit hoping to make that extra 50 bucks.

2. You were up $150 on that trade but now are only up $100 and you are greedily trying to get back to where you were.

3 Trying to make too much in general, if you have a $10,000 account and are trying to make $1000 a week, your greed will lead to oversized positions and set you up for bigger losses than you can afford for your account size.

Revenge: Revenge is you fighting against a market or position, refusing to accept a normal loss and needing to prove you are right. Like if you just lost $400 on a Tesla iron condor and then change your normal trading strategy to make it back by doing a strangle or doubling your size next time. The market is not your enemy, you need to accept that you will have losing trades and not to let them cloud your judgment, instead learn from them.

Anger: Slightly different than revenge but usually led by the same situations. Anger can also be directed at yourself for having a losing trade or doing something you shouldn’t. Like letting a small loss get too big. This may cause you to not follow your exit plans on other trades looking to make money back or to just make stupid trading decisions. When you do find yourself angry at the markets, you shouldn’t make any trades until you have mellowed out, as it may lead to revenge trading.

Ego: Ego is usually a result of a winning streak where you think you are invincible and end up throwing your money management rules out the window. Learn to be humble and know that a streak can turn awfully fast. I am currently on a good streak, I have been longish with my trades and the market has rallied almost 20 percent in 2 months. I am now being extra careful not letting it get to my head as I know it can turn around tomorrow. The S&P is currently trying to break its down trending 200 day moving average, so instead of getting aggressive as I am doing good, I am scaling back and lowering my Delta now because I can admit I have no clue what it will do next. It may hit resistance at the moving average and fall off or it may break out to the upside. As I scale back in size I know I may miss a big move if it keeps rallying, but this is where I have to but my ego aside and say “So What”, at least I won’t get hurt if it drops.

Doubt and Fear: On the flip side of ego is doubt and/or fear where you feel like you can’t do anything right and start freezing up. There are times when you may have a great strategy but the markets are doing their own thing. This is normal and as long as you are trading within your capital limits it should be absorbable. If you don't make trades or set your stops too tight because you are scared to lose money you can be missing many opportunities. There is also the fear of taking a loss. Losses are a normal part of trading and you need to accept them at the proper levels before they get too big. You should not start trading differently when you feel these emotions, just stick to your plan but lower your risk. If you can't trade because you are doubting yourself, I would take a break and reevaluate your strategies and plan.

Depression: After doubt may come depression that you will never become a successful trader. You need to remember that probably every single trader has gone through the same thing and has had losing streaks, made mistakes, taken huge losses and got wiped out at least once. Welcome to trading. If you are trying to trade while depressed about your results your trading will suffer even more and I would take a short break to clear your mind.

Boredom: This one has given me much trouble, especially in my youth, when I constantly needed to trade something. If I had buying power left, I would keep looking for trades to put on.

When there really is no need to make another trade, and monitoring your positions isn't enough because you are bored and you need new action you will start deviating from your plan. You can end up convincing yourself, "it's okay to make this quick daytrade" and then watch as its goes bad. You may end up holding it for three days and become preoccupied on a trade you should never have made. Stick to your plan and once you have your set number of trades on or reached your capital limitations, don't make boredom trades.

Panic or Anxiety: This is something you will feel when you start trading positions beyond your risk levels. It could end up paralyzing you or making you exit things you wouldn't have if you had followed your rules. There is no need for panic if you are trading acceptably sized, diversified positions. With the expectation of extreme outliers if you stick a good plan any loss should be a normal part of trading and not cause stress. If it does, then you are trading beyond your means.

Hope: Hope is not a trading strategy. When you find yourself saying I hope it works or I hope it turns around, you most likely have a bad position **that** has gotten away from your plan.

MAKING A TRADING PLAN

Now comes the task of putting it all together and making a trading plan. Having a plan can get you into a routine from the moment you sit at your computer to start your daily review and research to how you go over your day after the market closes. Though I can open the door and give you guidance you need to make one that is tailored for you, with rules you can follow. A trading plan will evolve as you evolve and become more knowledgeable both about yourself and the markets. Each trader differs in risk profile, account size, how many trades they are comfortable in holding at once, holding times of trades, preference between daily, weekly and monthly expiration, profit expectations, what type of stocks they prefer (slow moving ones or crazy ones). Some will prefer a few big winners versus a lot of little winners. Some may have a full time job while others are watching the market all day. There is more but this is enough to get you started thinking.

Annualized Goal and Other Objectives

The first thing I would have is what your realistic expected rate of return is, hopefully you didn't say 14,000% per year, but something more reasonable like 20% for the year or 2% percent a month. Pick a reachable target to aim for like grow account by $500 a week. I want to be able to live off my trading in 3 years is a reasonable goal, while I really want a Lamborghini in each of my mansions is a stretch.

You may also want to lay out a learning curve progress, "I will learn and master one new options strategy every month, I will learn how to use Greeks better, I will keep learning by________________.

Risk Plan

I would start with your risk management parameters which I laid out in previous chapter. Being that risk is the key to your success, this is one step you should not put off, because being oblivious to risk ~~can~~ will lead to a disaster. I would do it immediately after finishing this book, which comes to a close in a few pages.

Make sure you have all your risk rules including:

Capital allocation

Diversification

Contract and position size max

Number of max positions

Max loss per trade

Max number of trades per day

How you will handle drawdowns

Shutdown and reevaluation levels

What is your max Beta weighted Delta you are comfortable with

What is the most Theta you will have on at once?

What Will You Trade

Going back to chapter 8 you should have your list of favorite things to trade that meet your liquidity criteria. This is not etched in stone, if you find good trading opportunities that meet your criteria or a good earnings trade, its okay to trade them. You can say I will only trade options in stocks or ETFs with average daily options volume of 50,000 contracts, with an IVR of at least 30%. Use a scanner to look for acceptable trades. I have a watch list of about 80 possible stocks, ETFs and futures I will trade options on and very rarely will stray from that unless I hear something good and it meets my level of liquidity.

General Trading Style

This is one that takes time to learn and comes with experience. It's where you determine what type of trader you are. Are you a very short term trader looking for 2 day moves or prefer to earn small steady Theta decay over 4 weeks? Can you handle the mind set of being an option seller or do you prefer buying options outright? Will you have only both bullish and bearish positions or try to stay Delta neutral? Will you have any unlimited risk positions? What technical indicators will you be looking and how will you use them? Do you lean on being a contrarian trader or trend follower?

Trading Strategies to Use

Here you can outline how you will trade once you identify a trade. This would include what options strategy you will use. What strikes you will employ. What probability of success you are looking for and so forth.

This could be that you will buy spreads or options outright if the IVR is below 15% or sell spreads if it's above 40%. Or on range bound markets use iron condors with a 20 Delta short option, or broken wing butterflies.

One of my go to strategies, if I have a directional opinion for instance, is I will sell a vertical spread with a short 40 to 45 Delta option if I can capture at least 1/3 the width of the spread in premium with a 65% POP. If I am more neutral I would look to sell that spread with the short option having a 20 to 30 Delta looking for a 70 to 75 POP. In flat market I will trade a 5 point wide 20 Delta Iron condor that has pays 1/3 the width in premium with a 65% POP. If IVR is low I will trade a diagonal calendar. I will typically enter into trades that have 30 to 60 DTE. If trading weekly options then I will enter with 14 DTE and exit with by 4 DTE. When trading covered calls I will sell 16-20 Delta calls with 2 weeks to expiration. I will use a BWB or ratio spread under so and so condition, etc. I will have up to 2 naked positions on per every ten trades I make. If the VIX is above 25 I will widen my normal strikes.

This part of the trading plan is what will define who you are and what type of strategies you prefer. This knowledge will come with time and trial and error. For now pick one or two strategies and learn them inside and out. If after reading this you decide, screw this crap, I am buying way OTM calls looking for that one YOLO winner every now and then, then at least it's a strategy that is suited to your liking and you should be able to follow it.

Entry plan

Before making a trade, you should have a checklist, even if mental, of what you need to see that leads to you asking "**IS THIS A HIGH PROBABLITY TRADE?"** with a yes. If it doesn't meet all your criteria ask yourself "why I would I make it?"

Some things to help you decide are:

Am I chasing it at this level?
Is the risk worth the reward?
What is the probability of success of this trade?
Can I handle the max loss?
When are earnings due?
Am I trading with enough days to expiation?
Does another trade add to too much Delta or change the balance of diversification in my portfolio?

As for entering a trade itself, an entry rule could be not to leg into a trade. Or to enter a trade by placing an order at the midpoint mark of bid and ask. If not filled after few minutes move it closer to a place it can be filled. In a very active option you can buy closer to the bid and sell close to the offer.

The Exit Plan

You should have conditions for exiting trades both winning and losing. Including profit and loss targets, time frames for holding, how you will scale out of trades, whether you will leg out of trades or not and so forth. It's best to plan out your exit when making the trade and before emotions set in and warp your mind. This was all discussed in Chapter 20 on exiting.

Monitoring Your Trades

Next your plan should include a methodology for monitoring your positions and portfolio. After each trading day ends I like to review any new positons I may have put on and make sure they were within my trading and risk parameters and that I made a proper decision, if not I question why I made it and get out the next day. There will be times you make a mistake (like buying a spread instead of selling it) and catch it later when reviewing, you should acknowledge it and remedy it right away.

A Warm Winter's Day

I was recently looking to sell a call spread on Coinbase, but it was 60 degrees in New York in January and a friend called me to go golfing, so I went. I entered the trade in on my phone while walking up to the 2th tee. Somehow I bought the spread instead of selling it, but only realized it that night reviewing my positons. I got lucky in that I was wrong with my assessment of Coinbase and it rallied big the next day and I got out with a profit.

With existing trades, every morning before the market opens you should run down your list of positions and see how they are doing and estimate how they will react on the open. I will check their Greeks, their IV levels, look at charts, my P&L in them and check the risk/reward of keeping on a winning trade.

I am always looking to see:
If the trade has reached a target profit?
How many days are left to expiration?
Is the trade near my targeted loss levels?
Is my IV assumption correct?

I will make a note of which trades I may want to take a profit on, or which is getting to a place I may want to take a loss and monitor those throughout the day more carefully. I always try to think of every trade as "would I like to make this trade if I didn't have it on". Using clear eyes will you help better monitor your trades.
I also look at my portfolio as a whole and analyze its risk, how diversified it is, how much Delta do I have, am I too long or short? Do I have too much Theta on? How much buying power I may have, do I have room for more trades, etc.? Then I try to access the market as a whole. Is it rallying, or range bound near a support line etc. I also like to know what the VIX is doing to see if it may be near an extreme.
I do another rundown of this before the market closes to get my portfolio in line if it needs it and to exit anything I no longer want, I will also make notes as to what I need to watch closer the next day. Luckily, I don't have 50 positions on at once so it's not that hard to monitor.

Reviewing
You should review your overall performance on a regular basis like every month or 3 months and yearly. This will help you know how you are doing and if you need to make any adjustments. You should try and keep track of which trades and strategies worked and didn't and why. What made you lose the most money? If you can keep a spreadsheet detailing how you did on every trade, then you can get a better sense of what worked and didn't.

KEEPING A JOURNAL

Easier said than done, especially if you trade a lot, but if you really want to learn and progress, keep track of your trades. This will be time consuming but it really is the only way you will actually know your progress. You should know why you made a trade and how and why you exited it and every detail you can think of in between, what Deltas did you use?, what was the IV?, and so on. Did you rush a trade? did ignore your exit levels?, did you hold too long?. At the very least having to write down your trades will keep you from overtrading.

Reviewing Your Performance

Reviewing your performance is much more than just looking at your P&L and saying I made 10% this month that's great. It's not an easy task when you trade a lot, but it will be easier if you keep an excel trade journal. It's a great way to know how your actual return compares to your expected return.

With a good protocol in place and some excel skills you should be able answer the following:

How many trades did you make in a week, month, etc.?

How many winning and losing trades did you have?

What was your best profit and worst lost?

What was your win rate?

What was the average holding period per trade?

What is your average win or loss per trade?

What is your average margin used per trade?

What was your average rate of return?

What was your average result per strategy?

Discipline

The best strategies and plans won't help you much if you can't keep to them. You need to make sure that your entries, exit, and risk rules are followed. If you have a good plan, stick to it and don't deviate. Don't make excuses for why you should do something, if you know it's not part of your plan don't do it. You need the discipline to stay focused and not trade all day and get caught up by every news story or stock touting analyst you hear. Discipline will help you overcome the emotions of trading. No one can teach you discipline, you either have it or you don't. But to be a top trader you will definitely need it.

MISTAKES

As a trader you will make mistakes, some may be stupid and careless like my buying a Coinbase spread instead of selling it and others take time to learn, The smaller your account, the less you can afford to make a mistake as it won't take much to hurt you. I don't consider thinking the market is going down but it goes up a mistake, that's just part of trading. Losing $2,000 on a trade you should have lost $300 because you decided to leg out of it and the market tanks afterwards is a mistake.

The self-inflicted careless mistakes can be selling a spread instead of buying it, or doubling up a position instead of exiting, trading 10 contracts instead of 1, buying calls instead of puts, forgetting you had a good till cancel order. I’ve done all of these over the years, and there is not much I can help you with this except say be careful and maybe don’t enter orders on your phone while on the waiting to tee off while your friend is rushing you. Once you realized you made a mistake, don’t be stubborn, JUST GET OUT.

Then there are the general mistakes traders will make and not necessarily new traders, every human will ignore some rule at one time or other. **This is just a partial list of mistakes you will probably make, reread the book for the answers how to avoid them.**

Making too large a bet on any one trade

Selling premium in too low IV stocks

Selling to close to ATM

Not being diversified

Having too many positions

Not knowing when earnings are

Selling too close to expiration and having too much Gamma risk

Not being flexible when the market changes

Trading out of boredom

Not having an exit plan

Ignoring your exit rules

Letting trades go to expiration

Letting winning trades turn to losers

Trading illiquid stocks

Not doing proper research

Rushing into a trade

Putting on too risky of trades

Having too much capital at risk

Revenge trading

Being too cocky

Being too directional

Picking the wrong strikes, Delta, or expirations

Not knowing the difference between luck and skill

Final Thought

GET YOUR 10,000 HOURS IN

No back testing, paper trading, watching videos, or reading books will be a replacement for tried-and-true experience. The best learning method is to put in the time trading. The closer you get to your 10,000 hours, the less likely you are to make mistakes so don't give up and trade small till then. When you do make mistakes, the most important thing is that you always, always, always learn from them.