Optimizing Forex Trading Profits

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Optimizing Forex Trading Profits

Introduction

Trading in the forex market can be highly lucrative for those with the proper tools and the knowledge and discipline to use them. These tools generally give the trader clear signals for entering and exiting the market with a profit. The key to successful trading is in keeping that profit.

Optimizing profits in forex trading can depend on the trader's particular trading style. For example, a day trader could optimize their profits by simply holding the winning trade for a slightly more extended period during that day's trading session. On the other hand, a swing trader might use a trailing stop-loss order on a successful trading position to ensure their profit does not turn into a loss.

While trading style may have a bearing on how a trader might maximize their profits, some methods for enhancing profits are not specific to a trader's style but can instead be applied to all trading styles to some degree. These techniques have to do with risk management and follow-up strategies, which enhances a trader's profit and decreases risk significantly.

Risk Management's Role In Maximizing Profits

The main focus of a forex trader, once they have a profitable position, is to manage risk. The first risk is that of losing the profit already made by holding the position too long and thereby incurring additional risk. Risk management generally represents a key component in most successful trader's trading plans and is one of the most important elements to optimizing forex trading profits.

Unfortunately, most novice and experienced traders do not give risk management the respect it deserves. However, a good risk management component to a trading plan can make the difference between experiencing a casual, minor loss and blowing out your trading account.

The risk management part of a trading plan can be as important to the trader — and should be as strictly adhered to — as the selection of entry and exit points for initiating and liquidating positions.

Ideally, risk management rules are clearly defined in the plan, and the trader should be fully aware of what they stand to lose and have some concrete idea about when to get out on every position.

To preserve capital and to trade profitably, a trader's risk management rules ideally become second nature. To optimize profits, profitable trades must first be made. Risk management tools that can be used to optimize profits directly are discussed in the following sections.

Position Sizing

Regardless of the forex trading strategy to be implemented, position sizing is a good place to begin for maximizing forex profits. The generally accepted rule of thumb is for a trader not to expose more than one to three percent of the account on any given trade.

The small percentage of the account risked on each trade is if the trader incurs a string of losing trades. With a low percentage risk per trade, a string of losers would typically not blow out the account.

While some traders use a percentage of the amount in the trading account for each trade, others prefer to build their accounts using a set dollar amount of risk per trade. Instead of 1 % of the account, they will use a flat $100 per trade to build their account to the level specified in their trading plan.

One way to maximize profits with position sizing is to use a range of one to three per cent of risk to be assumed on each trade. For a position that has a higher perceived probability of being profitable, the trader can make a higher percentage trade.

For example, if a special opportunity presented itself in the market that the trader had discovered through their forex analysis, they would then make a three per cent trade sized trade on that currency pair. Conversely, trades which are perceived as likely to make a smaller profit would be established at the one or two per cent level.

Trailing Stop Orders

Limiting risk and maximizing profits have the common goal of preserving and increasing capital. The stop order is an excellent example of a trading tool used to limit risk and maximize profit. While generally used to exit the market when the trader is wrong, stop orders are also used to protect accrued profits when used in a trailing stop strategy, for example.

A trailing stop is generally used once a profit is seen in the currency exchange rate. The stop order is then placed to ensure that a minimum profit is realized and that the underlying trend is followed to continue profiting from the move. The trailing stop order can be placed at any level worse than the market, and as the rate rises or falls, the trailing stop order is adjusted higher or lower depending on what direction the position is, but only ever towards the current market.

When the trailing stop is eventually triggered, the trader may look for an opportunity to re-enter the market at a more favourable level or they may opt to take an opposite position if the exchange rate looks like it has reversed. Using a trailing stop-loss order helps ensure that the trader’s profit is not ridden into a loss.

Timed Stops

Before a corporate treasury manager can hedge their company’s foreign exchange risks, they first need to know how to recognize them and determine what amounts they exist in.

Although customized corporate forex risk management systems may exist, a simple and widely available tool that can be used to begin assessing and computing your company’s currency risk immediately is a spreadsheet program like Microsoft Excel.

The first step would be to make a column for each currency containing all of the long or short exposures to that currency you are currently aware of along with what date they are associated with, if known, and a brief description.

The next step will involve seeing if any exposures offset each other so that you can hedge them internally.

Next, those exposures that have no offset and are known, as opposed to contingent, can be hedged with forex forward contracts or with zero cost currency option combinations that allow you to express a market view on that currency versus your domestic currency.

Contingent forex exposures can usually best be hedged with purchased currency options, especially if the amount to be hedged is significantly in question or if the exposure may not materialize at all.

Maximizing Profits And Trader Psychology

To effectively maximize profits in forex trading, developing a consistently profitable trading system and the discipline to adhere to its rules is the first step for a trader who wants to be a success.

To develop a trading system that is profitable, a good amount of research and testing is needed, along with the proper trading psychology on the part of the trader once live trading has been initiated.

Before engaging in forex trading in a live forex account, the best way for a trader to start is by applying their trading strategy in actual market conditions in a forex demo account. Demo, forex trading accounts, are offered by virtually every principal online forex broker, and they also often support the Metatrader 5 trading platform or provide one of their own.

The Metatrader 5 trading platform comes with a complete technical analysis package and software to customize their trading program. The best way to learn is by practising, so trading in a forex demo account allows the trader to see weaknesses in their trading plan, which can be changed before trading in a live account.

Maximizing Profits And Trader Psychology

In addition, by trading in the demo account, the trader can have a firsthand experience of how well they deal with the emotions that come with losses and profits and how well they can manage their account, all without incurring any personal financial risk. Traders without a proper trading plan are prone to panic and confusion when the market takes unexpected swings.

Even with a trading plan, a trader can have emotional reactions which could — and generally do — adversely affect their trading. This is the reason for taking a sufficiently long period of time to familiarize oneself with the market and how one deals with gains and losses to ensure that consistent profits can be made once trading in a live account begins.

When it comes to optimizing trading profits, the trader's psychology is of utmost importance. Avoiding getting too greedy, keeping a cool head in the face of adverse market moves, and knowing whether to pull the trigger on trades are essential elements to profitable forex trading.

Once the trader feels confident with their trading plan in a demo account, and has taken the time to know that they can be comfortable despite adverse market conditions, the trader could open a micro account, which is a forex account that allows trading in micro units of 0.01 and up.

Maximizing Profits And Trader Psychology

A micro account can usually be opened for a nominal amount of money and gives a trader the added dimension of having a stake in their trading — albeit a small one.

The fact that the trader adheres to a specific trading plan and implements sound money management principles does wonders for a trader's overall longevity in the forex market and can assist greatly in optimizing their forex trading profits. This in itself is an indication that the trader has the right psychological profile to become consistently profitable.

Despite the fact that only thirty percent of retail online forex trades turn out to be profitable, retail online forex trading has become increasingly popular. Realistically, however, becoming a forex trader that can show consistent profitability can generally take anywhere from six months to five years of hands on market experience, so do expect to spend some time getting there.

Volatility And Its Effect On Trading Profits

The forex market has been known for its volatility for a long time. As a result, banks and other financial institutions generally hedge many of their positions in the open market, either through forwards, futures or options.

When trading currencies, profits should be taken often and as soon as any sign of resistance to the immediate trend which led to the profit can be noted. The reason for this is that a profit in a forex trade can turn into a loss at the drop of a dime, or more accurately, after any given economic release in the underlying currency's country. However, it is wise to remember that no one ever went broke by taking a profit.

Therefore, unless the trader is in a position for the long term and has considerably deep pockets, profits in forex trading are better taken sooner than perhaps not at all. However, even under these conditions, if the trader has a stop-loss order in at a worse rate than their entry-level, that order could be hit, and the trend could resume immediately afterwards.

Basically, forex trading involves dealing with a volatility factor that could take a trader out even if they are correct in their market forecast.

Volatility And Its Effect On Trading Profits

For this reason, many forex traders stick to day trading or swing trading, with banks, financial institutions, fund managers and large corporations with deeper pockets making most of the longer-term trades, which are often hedged.

To maximize forex trading profits, the key is to have consistent profits first. This entails the development of a successful trading plan with a risk management component that has been tested in a forex demo account. Once these two elements are completed, the trader must be sufficiently disciplined to adhere to their trading plan and implement risk management successfully. After all of these conditions are met, maximizing profits can become a priority and trailing stops can help considerably.

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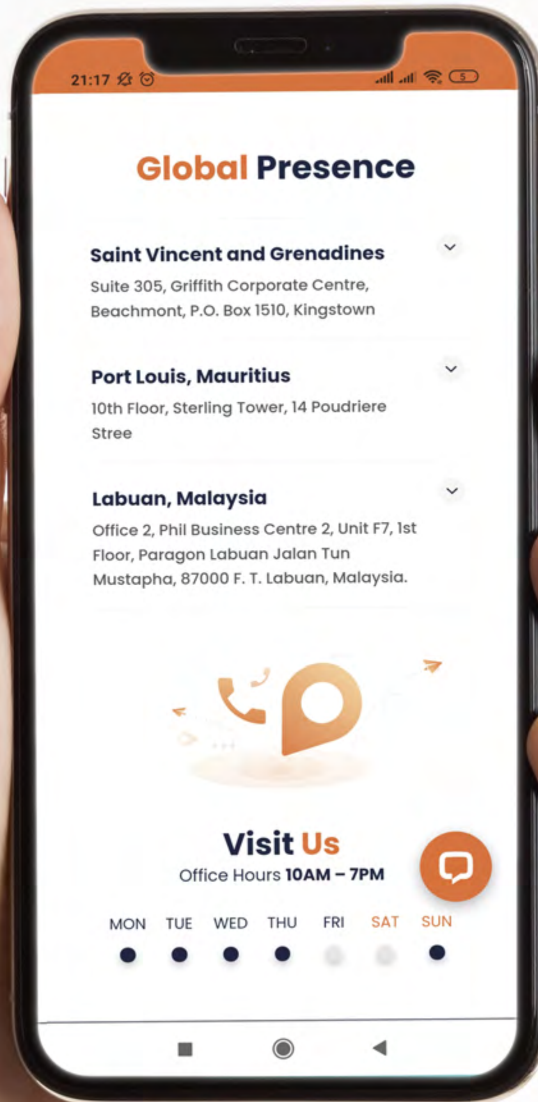

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