Trade Market Behavior, Not Market Forecasts

By Robert Miner, Dynamic Traders Group, Inc.

Forecast - *To predict a future condition or occurrence*.

Most of us would love to know what the future holds in store for us. Many of us believe the future can be predicted. Do we need to be able to accurately predict the future in order to be a successful trader? What place does forecasting have or not have in the life of a trader?

Beware of Forecasts and Forecasting

Once a forecast is made, the attitude of the mind shifts into a mode that may make it very difficult to make an unbiased trading decision. If the person believes the forecast, they believe they know what will be the future. The mind will automatically do every thing possible to only accept information that agrees with and validates the forecast. The mind will either ignore or consider not valid any information that contradicts the forecast.

If the market unfolds in a manner that is not consistent with the forecast, the trader will often maintain that the forecast is correct and make up all kinds of excuses why the market is wrong and will soon begin to conform with the forecast.

Probably the most obvious example of this is the forecast many Elliott Wave analysts made following the Oct. 1987 stock market panic. Do you remember all of the 1929/1987 comparisons and the forecasts for a "Supercycle" bear trend for the years following the 1987 panic? As the stock market continued to advance following the Oct. 1987 low, the bear-market forecasters continued to view it as a correction and shorted each Fibonacci retracement. Even as the stock market continued to advance above the Aug. 1987 high, the bear market forecasters refused to believe they were wrong and continued to call the advance an "irregular" correction and the forecasted bear trend was "imminent."

The bear market forecasters never accepted the reality of the market position. They had not identified in advance what market activity would invalidate the bear market outlook. No matter how high the market continued, they would not accept that they were dead wrong in their forecast. How costly do you think the bear market forecast was to those who held to the forecast long after the market clearly demonstrated that the forecast was incorrect?

Identify Present Trading Opportunities

If we deal with present circumstances, we have the best opportunity to create a profitable future. The future is a consequence of present activities. If a trading decision is based on present conditions that have a high probability outcome, aren't we forecasting the future each time we make a trading decision? There is a subtle distinction between a market forecast and a trading decision based on high-probability outcome.

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By definition, a forecast is a prediction of the future. The prediction is based on the current position or condition of the market. The current condition is a result of and embodies all past activities. But a forecast usually does not include clearly defined parameters for what would invalidate the forecast. In other words, the person making the forecast tends to believe the forecast is what will happen, not what may happen. A forecast that does not include the specific market activity that will clearly and definitely invalidate the forecast is a forecast that should not be considered seriously. In the language of a trader - "What is the protective stop-loss for the forecast?"

A trader who identifies present conditions with a high probability outcome is in effect, making a forecast of the future. However, the trader also is clearly accepting the fact that there is a probability the outcome will not come to pass. Less than 50% of trades are profitable for the vast majority of professional traders. That means they are more often wrong than right! How do they make a living by trading if they are wrong more often than they are right? Trading strategies and money management are the keys to successful trading - even more so than a positive win/loss ratio.

Beginning and unsuccessful traders have a very hard time accepting that consistently profitable trading usually includes more losing than winning trades. That is why they concentrate their educational efforts and trading strategies on trade entry techniques and often ignore the equally important trade management strategies. I know many unsuccessful traders who are amazingly accurate identifying trend reversals and trade entry strategies, but consistently lose money because they fail to use the proper initial protective stop-loss to minimize a loss or protect unrealized profits if the market unfolds in the anticipated direction.

The Three Elements of an Acceptable Forecast

From my point of view, a forecast is only of interest if it includes the following three elements.

1. What is the most likely outcome of the current market position? This is the prediction of the future or the forecast itself.
2. What specific market activity will <u>invalidate</u> the forecast? This could be described in many different ways depending on the approach of how the forecast was made. It could be a price or time level that must not be exceeded if the forecast is to remain valid.
3. What specific market activity will <u>confirm</u> the forecast? This should also be described within the context of how the forecast was made. It could also include a price or time level that, if exceeded, confirms the forecast should be correct.

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Traders should want to profit in the long run no matter what the outcome of the market activity. We should not be concerned with whether a forecast becomes

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reality, but whether our technical analysis approach and trading strategies allow us to limit losses and maximize profits no matter what direction the market takes.

A few weeks ago I was giving a short workshop on my Dynamic Trading approach to technical analysis and trading strategies to a group of about 30 people interested in technical analysis. I asked for a show of hands to a three-part question. The question was - Who thinks 1999 will be a bearish year or bullish year for the stock market and who doesn't care? About 2/3rds chose a bearish year and 1/3 a bullish year. Only one person raised his hand for the "I don't care" choice.

There was only one person in that group who understood the business of trading. Successful trading is not about forecasting but about trading market behavior. By the way, that one person has been a full-time trader for almost 30 years!

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To learn all of the Dynamic Trading technical analysis and trading strategy techniques, read Robert Miner's book, *Dynamic Trading*, named the 1999 Trading Book of the Year by the Supertraders Almanac.

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