

Full Time Trading – What is involved?

I receive many emails from people with a wide range of backgrounds asking the following question:

I am attracted to the idea of giving up my present occupation and becoming a full time trader. Is it possible to make a living from trading?

The first observation to be made about this question is that it usually comes up when the markets are in a bull run. It seems so easy to make money trading. We constantly hear all sorts of people boasting about how much money they are making from trading. There are a plethora of promoters offering to sell systems for making enormous profits from trading the markets. However, markets change and during the bear trends, I am rarely asked this question. Indeed, there is an old caveat in the markets about not mistaking a bull market for brains. Many people do and find out the hard way that there is no simple way to make an easy living from trading.

Two callers stand out in my memory:

The first was from a person who had never traded the markets before who had \$30,000 and intended to borrow \$300,000 through his broker to trade the markets full time. He seemed blissfully ignorant of the level of financial risk he would be taking, especially if he traded derivative markets. His risk of ruin was a near certainty.

The second was from a person with \$25,000 to trade with, who has spent about \$10,000 of his capital buying a computerised trading system. He needed to make 70% return on the remaining capital before he broke even in the first year.

My advice to the first of these callers was to stay in his present employment and not borrow any money until he had been able to establish a track record of profitable trading on the \$30,000 capital he had. Once he had a track record on this scale over several years, covering both bull and bear markets, should he consider borrowing to trade or giving up his employment.

Unfortunately, it was not possible for the second caller to retrieve his \$10,000 dollars, so it was likely it would take some years to trade back to his starting position – if the trading system worked. Had he not already spent the \$10,000, I would have advised him to keep his overhead costs as low as possible, say by manually charting a few contracts and making his own trading decisions, until he was sure he could make money trading. I say this, because trading the markets is not an easy thing to do successfully. Many people are simply not cut out for it. They want the excitement of trading, but lack the discipline and other qualities that are needed. No trading system can really make up for defects of character and attitude.

What it comes down to is that most people think that other professions are so much easier than their own. For some unknown reason, they think trading is easy, despite the fact that some of the brightest and best educated people in the land work in the industry. If tempted to take this view, we should turn the proposition around and ask what we would say to a trader who thought our profession sounded like a glamorous job and that it was easy to make living at it.

What it boils down to is: Why do we think we could easily become a successful trader, when we

would not expect a trader to be able to hang up a shingle tomorrow and make a good living in our game without training and experience?

The statistics are really quite brutal for trading. Somewhere near 90% of traders lose their capital and drop out of the markets within one year. Around 90% of option contracts expire worthless. And so on. I often remind people that trading is a small business and that 90% of small businesses fail within a few years. The statistics for trading are no better and there is no reason to expect them to be otherwise. Indeed, one of the most common reasons why small businesses fail is because the proprietors go into a business for which they lack knowledge and experience.

The biggest mistake the failures make is expecting to make ridiculous profits on small capital. If 100% returns or better were possible, it would be the most profitable business in the country and the returns would soon be arbitrated away as the best business people in the country switched into trading. The way I usually put it is: Good traders average something like 15 - 20% pa return over all market cycles. If a trader has a verifiable track record in that range, people with funds will beg the trader to manage their money and pay them exceptionally well to do it. So, it is reasonable that beginners should assume that they would not be in this class until they have experience and knowledge. A more realistic target might be 10%pa.

To answer the last part of the question, the beginner then has an easy calculation to make: What income do they have in mind as a living to be achieved from trading? Whatever they come up with: multiply it by 10 to get the minimum capital required. And it is a minimum, because at that level, they are just living off their trading. There will be good periods and bad periods. If a bad year comes along first, which is highly likely, they will need to use capital to live, which reduces their capital for trading. More, importantly, if they need all the income for living, they are not increasing their capital to cover inflation, so they are in fact going backwards.

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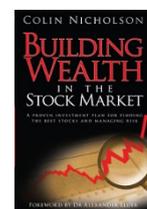
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