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### Weekly Trading Education Article

## Do I Trade the Forecast or the Market?

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A number of my clients have asked this question and others have wondered what it means, so I want to talk about it. Many trading systems and just about all opinions of market direction aim at forecasting the market. Whether the trader uses fundamental or technical analysis, if an opinion is being generated, the trader is attempting to forecast the market.

Some use Elliott Wave theory, some rely on P / E ratios, but the overall purpose is to estimate where prices will be at some point in the future. These types of analysis can, at times, be pretty accurate, but not always. As traders and human beings, we will always have opinions and ideas based on our beliefs about what we have experienced. No matter how hard we try not to have opinions, we just can't seem to help having them.

As traders, we must be concerned with how we use these opinions, forecasts and beliefs; that is the important issue. As far as the markets are concerned, the first and foremost thing to realize is that all these opinions or forecasts about the markets are nothing more than fantasies because, at the moment, they do not exist in the real world.

Do we want to trade fantasies? Obviously not! But, how can we use these forecasts to help us trade instead of hurting us? These are important questions. Let me give some examples and analogies of how forecasts can help or hurt us.

Let's say you believe the forecast based on Elliott Wave theory indicating that stock XYZ is about to begin a trend up. Even the MACD is indicating positive divergence. You say to yourself, "It's a no-brainer; I'll buy here and wait."

A week goes by, and, instead of beginning its up-trend, XYZ stock goes lower. You tell yourself that you entered this trade too early, but that you BELIEVE it will head up very soon, so you hold on another week.

The next week the stock goes even lower, and now you are really worried. The MACD bullish divergence is still present, and the Elliott Wave forecast remains the same, but it looks as though it is heading down for one last time; "A shake-out," you say. You think to yourself, "Can't go any lower," so you hold on.

The next day the stock plummets; you panic and sell out your position and scratch your head asking yourself how this could happen? The answer is that it happens all the time to traders who trade the forecast and **not** the actual market!

In this example, the trader held onto his fantasy based on his forecast. His faith in his forecast prevented him from avoiding placing a stop-loss, which is typical for traders locked into this type of forecast.

trading. After all, their egos are involved here too.

Now, let's take that same example and show how to use the forecast to our advantage. Instead of just buying the stock outright based on its positive forecast, we wait until the stock shows signs actually reversing its trend down.

We feel that, based on our forecast, this stock will turn around soon, but the **current reality** indicates that it is not happening now. So, by not buying the stock and instead waiting for the price of the stock to show signs of actual strength, we as traders are "Trading the Market and the Forecast." However, we are using the forecast to get ready and to keep this stock in our list of possibilities.

I want you as traders to look at forecasts to help round out your trading. It is another tool in your bag of tricks, so to speak. Use this analogy as a way of thinking about forecasts:

You're planning a sailing trip for the day. You check the weather forecast, and it is not good; heavy rain and wind are expected. You have a great boat, you're an experienced sailor, so off you go.

As you leave the dock, the weather is perfect. It is sunny with light winds. Now, I ask you, even though the forecast is for very heavy rain and winds, would you wear your rain gear now or wait until conditions change? I think most of us would wait until conditions actually changed.

You would also set the sails of the boat to match the current weather conditions and winds and not the forecasted conditions, which may or may not even happen. If you put up small storm sails now, you will not be able to sail the boat in the current light air conditions.

As weather conditions change, you change along with the weather! The sailor in this example would use the forecast to be PREPARED for the possibility of bad weather by bringing rain gear and the proper sails and crew.

It is the same with trading! Whatever the forecast is, take note, but trade with the current conditions and be ready if conditions change. In other words, "Trade the Market, Not the Forecast!" Or, maybe another way of putting it is to "Live in the Present and Not the Future or Past!"

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