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Rates Of Return – A False Sense Of Security?

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Rates of return in the trading industry seem to be very important. But are they? We certainly see them everywhere, like on trading system advertisements, on mutual fund brochures, and hedge fund performance reviews to name just a few.

The problem with rates of returns is that they can be misleading and past performance does not equal future performance. Furthermore, with trading systems, we can go further and say rates of return will vary from trader to trader. This is where many traders that rely on rates of return get into trouble. They see an advertisement of a trading system promising 80% returns with compelling trades and exact dates and money made. But what you don't see is the fact that YOU will more than likely not trade exactly this trading system the same way as advertised, and therefore your rates of return will be different. The markets and time frames you choose to trade will effect your returns as will your psychology, money management skills (or lack of), and your execution skills.

Most trading system advertisements may also “cherry pick” the best day, week, month, or year to show you, in other words, you may not be seeing the entire picture. Maybe a trading system did great one month and not so good the next, but the advertisement did not show you the poor month. So it is important to take rates of returns with a grain of salt.

Another great example of rates of returns being misleading is that past performance does not guarantee future performance and an excellent example of this is the mutual fund industry. In 1999 most stock mutual funds were boosting stellar gains for the last 5 years! Many, many mutual fund buyers basing their investment decisions on rates of returns got a real eye opener if they bought funds in the late 1990's. By 2002 most of them were scratching their head thinking what went wrong, the fund had such a great track record was now down and losing them money!

Novice traders need to be very careful about basing their decisions on rates of returns, whether purchasing a trading system or purchasing investments.

When looking at a trading system, your goal should be can YOU trade it, and does it make sense to YOU? Also does the system provider give you many charts to review, and do they make themselves accessible to you BEFORE YOU BUY? Are the charts

mysterious or are they clearly labeled illustrating trade entries and exist with risk control and “Trade Size” parameters? Do the entries and exist make sense to you and are they in-line with your trading style? These are the important questions you need to know. Does the system provider offer on-going instruction in the form of classes, and support? Are you able to talk to one of the creators of the system or are you just able to reach a customer service representative? These types of questions are far more important than rates of returns because ultimately it will be up to YOU to trade the system well. What you do need is support, and to have the best trading “tools” available which is a trading system that makes sense to YOU.

You can have a terrific trading system but if you do not trade it well, meaning poor risk control, poor psychology, and poor trade execution you can end up losing.

Remember, “Past Performance Does Not Equal Future Performance” and your trading results will be different than others even when trading the SAME trading system! So take rates of return with a grain of salt so to speak. The key is to find a trading system that makes sense to you and one that YOU can trade well.

Good luck & Trade Well!

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