Special User Guide

Your Guide to Automated Trading Systems: *What You Need to Know*

By Matt Zimberg,
President Optimus Trading Group
www.optimusfutures.com

Your Guide to Automated Trading Systems: What You Need to Know

By Matt Zimberg, President Optimus Trading Group
www.optimusfutures.com

Legal Disclaimer

THERE IS A SUBSTANTIAL RISK OF LOSS ASSOCIATED WITH FUTURES TRADING. SUCH TRADING IS NOT SUITABLE FOR ALL INVESTORS. AN INVESTOR COULD LOSE MORE THAN THE INITIAL INVESTMENT. TRADING SHOULD BE UNDERTAKEN WITH RISK CAPITAL ONLY. RISK CAPITAL CAN BE DESCRIBED AS EXCESS INVESTMENT FUNDS, THE LOSS OF WHICH WOULD NOT HAVE AN ADVERSE IMPACT ON THE INVESTOR'S LIFESTYLE.

The Internet: New Independence for the Investor

The evolution of the Internet has bestowed unprecedented freedom upon the average retail consumer. We now have the ability to do research, compare prices and therefore make more intelligent purchasing decisions than we ever could before.

The Internet has further evolved to give the investor or trader **the ability to conduct secure transactions in seconds or less.** The power of traders to do their own research and make independent decisions has brought forth fierce competition in technology and prices.

Many of today's most successful brokerage firms also offer some of the best technology for price execution. Some trading applications are simple, while others are sophisticated and complex systems which allow charting and applications of technical analysis within seconds to moving prices. The most advanced trading technologies allow a trader to back-test strategies based on previous price action.

Does the Web Help the Average Investor Succeed?

With the meltdown of the markets in 2008, many have come to realize that traditional investment advisors don't provide any hedge or edge when it comes to portfolio management. In my opinion, more and more investors are refusing to pay the high commission fees of yesteryear. With this growing trend towards independence, the number of online traders is expected to increase.

However, in my opinion, even with advanced technology and cheaper transaction costs, the odds are against the average trader being able to perform well in the markets long-term.

Why?

The brokerage houses that specialize in high-end trading technology operate in much like software companies. Yes, they do provide a gateway to the markets. BUT when you associate with these brokerages, they expect you to build your own methodology, implement it and execute it.

In fact, I can name several brokerage houses off the top of my head that provide excellent technology, and make a earnest effort in advancing their technology: user interface, low latency execution, and other helpful trading features. In all fairness, some are really good at what they do, but again they are not there to help you choose a trading methodology based on your personal risk tolerance and available risk capital.

If you are an advanced trader, more than likely the solutions above could fit you. If not, then you should consider learning how to develop a methodology based on the markets you trade or otherwise acquire one.

Emotions: The Downfall of the Average Trader and Investor

When we talk about trading, we are talking about money, and when it comes to money, **emotions rule.** Sadly, emotions of fear, greed, hope and uncertainty can sometimes cause crippling losses in a trader's account.

Furthermore—and this is something that most will not admit—most traders and investors simply do not have a well thought-out plan or **trading methodology**. Most still rely on TV network news, newspapers, and online research to make their trading decisions. And rarely does this barrage of news help the overwhelmed trader get on a path to profitable, consistent trading.

The bottom line is that most traders will exit a position with a minimal win while holding on to losing positions. The nature of most traders works against the flow of the markets. That's why being armed with a trading methodology is so important: **it ensures that your emotions don't get in the way of your ability to trade intelligently.**

Trading With a Methodology: The Basics

A trading methodology that seeks to profit from the markets consists of the following components:

- The conditions met for entry
- The conditions met for exit
- Parameters of risk
- Parameters of reward
- Volatility (when to stay out)
- Back-testing capability

Each of these elements above is equally important when building a system. These are things that most traders do not consider when building their trading methodology.

Before we continue into the next section, I want to stress that we at Optimus Trading Group have **no intentions of criticizing traders who attempt to trade on their own**. We appreciate the fact that traders attempt to become more educated, and we respect the time they dedicate—between seminars, books and online forums—to bettering their trading skills.

The solution we offer is designed for those who lack the time to trade or to conduct the painstaking research required to become a truly profitable trader.

Welcome to System Trading

What is a trading system? One of the best definitions we have found is on Wikipedia:
"In electronic financial markets, trading system, also known as algorithmic trading, is the use of computer programs for entering trading orders with the computer algorithm deciding on certain aspects of the order such as the timing, price, quantity of order. It is widely used by hedge funds, pension funds, mutual funds, and other institutional traders to divide up a large trade into several smaller trades in order to manage market impact, opportunity cost, and risk. It is also used by hedge funds and similar traders to make the decision to initiate orders based on information that is received electronically, before human traders are even aware of the information."

In other words, the computer makes buy-and-sell decisions based on certain criteria and market data. Good systems typically incorporate the six variables that we mentioned above. However, trading systems vary in their complexity, and some systems may integrate other variables that set its criteria for entry and exit. Some of the variables that systems may use differently are: time frames for analysis, volatility percent, markets traded, risk parameters, length of trade, etc.

Although a broker is needed to set up the system's trading strategy for a customer's account, most systems are programmed to be auto-executed by the computer. After all, this is the purpose of a trading system—to trade without human interference.

Futures/Commodities Trading Systems Diversification

Futures contracts provide global diversification with markets such as agricultural contracts including wheat and soybeans; equity instruments such as the E-mini S&P and Dow Jones; debt instruments such as bond and treasury futures; energy contracts such as oil and unleaded gas; metals such as gold and silver, etc.

Above all, futures contracts provide the ability to capitalize on both rising and falling markets. You have to be on the right side of the market to benefit from it.

There is a risk of loss in futures trading. Such trading is not suitable for all traders. An investor could loose more then the initial investment.

The Advantages of a Trading System

Let's assume that your trade has met your set of conditions and technical indicators, would you pull the trigger on a buy signal? YES? NO? Would you *still* pull the trigger if the TV was on and the Dow Jones was down 500?

See our point? Emotions! Because you were scared and acted on your emotions, you may have saved yourself from a horrible losing trade—**or perhaps you missed out a perfectly good trade.**

Here is a summary of how human emotions can dominate the trading process:

Fear is an emotion that makes us skip perfectly legitimate trades.
Greed makes us get out of trades too early.
Hope makes us stay in a losing trade for too long.

This is precisely why you should consider trading systems. Because once your set of conditions has been met, a trade will go through. If a trade moves in the favorable positions of the trend, the system will not get out of it because of "greed." Conversely, if the trade is wrong, the system will not stay in it because of hope.

Sound trading systems have the ability to trail favorable positions while getting out of unfavorable positions. The use of stop loss orders may not protect profits or limit losses to the amount intended as certain market conditions make it difficult or impossible to execute such orders. The specific amount of the gain or loss may vary from system to system. Let's discuss what set of criteria you should examine when choosing a trading system.
Automated Systems rely on streaming and accurate data from the exchanges. However there could be instances where there are interruptions in data, due to many reasons. This could prevent signals from being transmitted or received and could effect system performance and positions.

Finally, remember that system results include slippage, that can work for and against you. Therefore fills reported by systems could be different from real life execution.

Factors Affecting Trading Systems

The trading of leveraged futures instruments has no guarantees. The risk of loss always exists, and as market participants, we cannot eliminate risk. However, what we can do is **increase our odds by applying a disciplined approach to trading.**

We believe that there are legitimate systems providers out there that have a very reasonable approach to trading—without the hype and without trying to minimize the risk involved. The leverage that exists in futures trading can work *for* you and it can work against you. Naturally, this could lead to large gains and large losses.

Therefore, a reasonable approach would be to start with a small number of contracts and risk capital (non essential funds which if lost would not adversely affect your livelihood) and follow your performance via your account access. Keep in mind that you should have a long-term view with any system you choose to employ in your portfolio.

Choosing the Right Trading System

As a trader and a consumer, the more knowledgeable you are, the better able you are to make intelligent choices. The rule of thumb is "if it seems too good to be true, it probably is."

Although systems can vary in terms of results, one key thing to remember is that high returns are associated with higher volatility and risk in a trader's portfolio. Furthermore, hypothetical results should incorporate factors such as commissions, slippage, and the ability to examine the liquidity of certain contracts as far as execution.

Here are some factors you should examine when selecting a trading system:

- **What is the cost of the system?** Systems typically have a leasing fee. Some vendors charge monthly, while some charge quarterly.

- **What commissions are charged?** Brokerage fees are associated with each transaction for each futures contract. You pay only when the system trades. Traditionally, you pay half on the way in and half on the way out.

- **What is the anticipated drawdown, and will it have an impact on carrying the positions?** Every system, as successful as it might be, can experience a drawdown. This is normal, because no system can meet all market conditions at all times. Just make sure that you are capitalized to withstand those historical drawdown.

- **What is the reasonable initial capital?** Each system has a recommended initial capital for trading. You should stick to this minimum.

- **Should I trade multiple systems?** You can, if you consider systems that are not related to one another, built by different developers, and trade different markets. For example, consider one system that trades bonds and another that trades the E-mini S&P. This could potentially diversify your portfolio and smooth out fluctuations in the account. Additionally, you could consider systems that trade multiple markets. The key here is to **diversify.**

- **What time frame does the system trade?** Systems are built on logic and time frames. As such, some systems have day trades, some have swing trades and others focus on longer-term trades. You may choose a system with a time frame that meets your comfort level.

Here are some other major factors that should impact your decision when seeking a trading system:

- *What are the credentials of the system developer?*
- *How long has he/she been selling the system?*
- *How are the system's trades being executed, technically speaking?*

As a president of a brokerage firm, I also make sure to ask the system developers if they will provide support once the system has been purchased or leased by the customer. This shows good faith and a desire on the developer's part to establish a long-term rapport.

Finally, you can choose a trading system based on your risk capital, your financial tolerance and the specific markets you would like to trade.

Final Words

Let us share with you the top 5 performing systems along with their historical performance records for your scrutiny and consideration. The selection of a trading system is a highly personal and collaborative process between the investor and Optimus. Before any system is selected an investor's risk tolerance, affordability, investment goals, and pros and cons of each system should be considered. Ask your Optimus broker for our top 5 system picks. You are under absolutely no obligation!

We have made a concerted effort to be as comprehensive as possible in this book, but we understand that you may have additional questions. For answers to these questions—or for help in selecting a system based on your criteria—please drop us an e-mail at support@optimusfutures.com or call **1-800-771-6748.**

There is a substantial risk of loss in futures trading. Past performance is not indicative of future results.