

||||| FUTURES
TRADING
SYSTEMS



Anatomy of Automated System Execution

By Steve Dahl



ASSET DIVERSIFICATION & TODAY'S FINANCIAL MARKETS

The globalization of financial markets has made asset diversification and managing portfolio risk more important than ever. Investors seeking a more sophisticated method of portfolio diversification have been turning to commodities. Futures contracts such as stock indices, debt instruments, currencies, energies, metals, and agricultural commodities offer an effective separate asset class to diversify an investor's securities portfolio. In fact, studies have shown that a portfolio consisting solely of stocks and bonds may potentially have inferior performance and more risk than a portfolio that diversifies using commodity futures. The recent growth of automated futures trading systems offers investors a viable and low-maintenance approach to achieving such diversification in commodities. Through Automated System Execution at Daniels Trading, it has never been easier to get started.

WHAT IS A FUTURES TRADING SYSTEM?

A futures trading system is a computer run software program that generates specific buy and sell instructions for futures contracts. To generate the entry and exit signals, the trading software may analyze both historical and real-time price data. Using simple to very complex algorithms, the system efficiently examines price patterns, trends, divergence, momentum and many other key technical indicators. By constantly monitoring price data, a mechanical system is designed to assess risk factor, profit potential, and probability of trade success. Trading systems have the ability to scan the market and pinpoint potential trading opportunities more efficiently than a human trader ever could. Trading systems are the product of a system developer's unique experience in trading the markets. Oftentimes the developers have dedicated years and even decades to constructing their trading strategies.

WHY USE A TRADING SYSTEM?

Whether you are a novice or an experienced trader, you must contend with the emotional aspect inherent in speculative investments. Traders frequently fall victim to the pitfalls of greed, stubbornness, fear, and disbelief. Each can damage the confidence of a trader and lead to irrational decisions in the market and losses. Mechanical trading systems offer investors a disciplined and unemotional approach to trading.

In addition, the sheer processing power of computerized trading systems ensures that a watchful eye is kept on the markets around the clock. It would be impossible for a human trader to perpetually monitor and analyze all global markets 24 hours a day. Below you will find a comparison of common characteristics of an Independent Trader versus the Trading System Investor:

INDEPENDENT TRADER	TRADING SYSTEM INVESTOR
<ul style="list-style-type: none"> • Trades emotionally 	<ul style="list-style-type: none"> • Mechanical, unemotional & consistent
<ul style="list-style-type: none"> • Rarely trades with a plan 	<ul style="list-style-type: none"> • Predetermined parameters filter trades
<ul style="list-style-type: none"> • Unable to monitor all markets 	<ul style="list-style-type: none"> • Constant analysis of global markets
<ul style="list-style-type: none"> • Spends hours studying markets 	<ul style="list-style-type: none"> • Minimal or no time commitment required
<ul style="list-style-type: none"> • Results vary erratically 	<ul style="list-style-type: none"> • Attempts to "smooth" the equity curve
<ul style="list-style-type: none"> • Subject to Human Error 	<ul style="list-style-type: none"> • Professional account management

WHAT IF I DON'T HAVE EXPERIENCE IN COMMODITY TRADING?

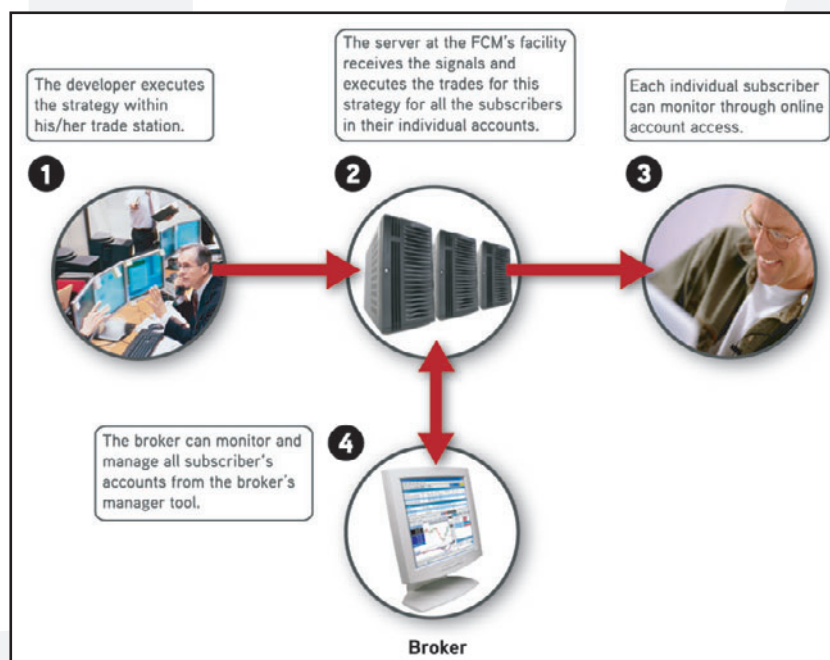
No experience in commodities is required to participate in trading systems. In fact, this is one of the primary benefits of trading systems. You don't have to be a market analyst or trading guru to be successful. After you have thoroughly researched and selected a trading system, you may request that the trading system be automated by a brokerage firm. Many choose to defer execution to a brokerage firm because they prefer a "hands free" approach that ensures professional execution and minimal time commitment. Automated system execution prevents an investor from having to be confined to a computer all day awaiting trade signals or monitoring the software. The vast majority of system developers recommend that investors employ the services of a reputable broker specializing in trading system execution.

HOW DOES DANIELS TRADING'S AUTOMATED SYSTEM EXECUTION SERVICE WORK?

Daniels Trading offers professional brokerage execution to help investors put trading systems into action in the marketplace. Our Automated System Execution program is designed to offer comprehensive support from the moment you start researching systems. Our system trading specialists will guide you through the system selection process while you research our featured trading systems.

Each client involved in our Automated System Execution program is assigned a personal broker who plays a critical role in the daily management of your account. As your trading advocate, your broker will oversee the trading of your account. Your broker is responsible for communicating with the system developers and back office personnel to make certain that the execution of your system meets your expectations. During implementation, you'll enjoy peace of mind knowing that you have a team of experienced brokers dedicated to actively monitoring your trading system and account.

Using proprietary technology, Daniels Trading offers a unique execution arrangement that is designed to improve the accuracy and efficiency of the trading process. Rather than having to manually place orders into customer accounts each time a system generates buy or sell signals, we are able to offer instant trade execution by integrating software that does it for us. Your broker still plays a vital role in managing the software to ensure that the signals are accurate and allocations are made properly. Below you will see a chart that depicts how it works.



Following along with the trading activity in your account is easy and fully transparent. Formal account statements are emailed to you and online account access is always available. Your personal broker will also provide you with ongoing feedback and guidance to ensure your trading system is reaching its potential.

WHAT COSTS ARE ASSOCIATED WITH TRADING A SYSTEM?

As in any financial endeavor, there are required costs associated with participation in programs that offer potentially lucrative returns. There are three cost components that investors are responsible for when following an automated trading system:

- **System Lease Fee-** The customer pays this fee directly to the system developer for “borrowing” his/her trading strategy. Most often system lease fees are a monthly or quarterly fee and can be arranged directly through the system developer’s website via credit card or PayPal. Some developers offer discounted rates to Daniels Trading customers along with the ability to pay the lease fee out of the brokerage account. Be sure to ask your broker contact.
- **Commission Fee-** This fee is payable to the brokerage firm on each transaction as compensation for managing your account and maintaining the resources required to run the trading systems. At Daniels Trading, we are mindful of these costs and remain committed to offering competitive rates.
- **Third-Party Execution Interface-** In some instances, trading systems require the use of a third-party interface that connects a live brokerage account to the real-time trading signals. This fee may cost up to \$1.99 per side and is typically debited directly from the brokerage account and payable to the third party software or interface provider that makes “auto-trade” possible.
- **Other Fees-** Several industry-standard fees are charged per transaction to all traders in commodities. These nominal fees are displayed as line items on your account statements when your system trades. Also, there may be a charge of the greater of \$75 per month or \$0.75 per side for use of the trading technology we integrate to fully automate strategies. Call your broker for details as they do vary depending on the market and exchanges the system trades.

HOW DO I KNOW WHICH SYSTEM IS RIGHT FOR ME?

There is a wide selection of trading systems currently available with new ones being developed as market dynamics change. With so many to choose from, how can a trader prudently select the right system? Since no two investors share the same trading objectives, you must ask yourself the following questions as you prepare to explore systems:

How much risk capital am I prepared to allocate toward system trading?

Since most trading systems have recommended equity requirements, determining your risk capital should be one of your first considerations. While some trading systems can be traded with as little as \$5,000 in equity, others may require \$100,000 and greater. You know best what portion of your overall investment portfolio can be allocated toward futures trading.



Am I seeking exposure in a specific market or in multiple market sectors?

The goal of single-market systems is to offer targeted exposure to an investor's market of interest. For instance, many systems trade exclusively the S&P 500 or stock indices. Other single-market systems may focus on markets such as Bonds, Currencies, or Metals. Developers of these systems have created a unique trading methodology that they recommend only be applied to a particular market or sector. On the other hand, multi-commodity systems provide trade instructions for more than one market sector and offer a broader spectrum of market exposure.

What is the velocity of trading I prefer?

The duration of the trades that a system generates can range from just minutes to days. Recall that trading in commodities can be volatile so long-term trading is not common in automated systems. Many automated systems are designed to capture price action in the market and then get on the sideline. In fact, many prefer to avoid the risk associated with holding positions overnight (day trade). The timeframe of trades in your system should coincide with your trading objectives.

What is my risk tolerance?

Most traders will respond that they want to risk very little, but still make a significant return on investment. However, it is important that traders have an understanding of how risk and reward relate to one another in any speculative investment. As a general rule, the more an investor is willing to risk, the greater the potential reward. Likewise, a lower risk tolerance should come with the expectation of more modest returns. In assessing trading systems, this involves comparing the equity drawdowns versus average returns. While past performance may not be indicative of future results, it is always prudent to analyze how a system has performed historically.

TIPS FOR A WINNING SYSTEM TRADING PORTFOLIO

While there is no "Holy Grail" to selecting trading systems, following are several considerations that may improve your odds of building an effective system trading portfolio.

Ensure that you are properly capitalized. Pay attention to the equity requirement suggestions of the system developers. It only makes sense that they know best how much equity you should allocate toward their system to withstand inevitable drawdowns.

Trade multiple, uncorrelated systems with varying timeframes. If equity permits, a trading system investor should explore the benefits of trading multiple systems. Each system should be unique in methodology. This diversification is aimed at reducing the overall risk and exposure in any individual system. Avoid putting all your eggs in one basket.

Closely examine the numbers. Most system developers maintain websites where you can view performance statistics of their systems. While some developers may offer "real-time" results based on actual trading, most provide hypothetical results accumulated by back-testing their strategies on past market data. It is important to note that hypothetical results have inherent limitations such as they are prepared with the benefit of hindsight and lack the impact of true financial risk. That being said, hypothetical results do offer investors the ability to evaluate key performance statistics such as the following: current year-to-date return, average return, average winning trade, maximum drawdown, average drawdown, and average losing trade. While past performance may not be indicative of future results, it is a good place to start your research.





Daniels Trading

EXCELLENCE THROUGH EXECUTION

Consult with an unbiased source. At Daniels Trading, our Automated System Execution team provides valuable guidance on trading systems free from any influence by developers. Since we receive no compensation for the sale or lease of the trading systems we recommend, we are able to provide candid feedback that is in your best interest. We have a vested interest in your success and helping you to meet your trading objectives. Contact a Daniels Trading system specialist TODAY!

NEED HELP?

If you have any questions about Automated System Execution or seek the assistance of a system specialist, contact Steve Dahl toll-free at 1-800-700-4258 (US only) and 1-312-706-7619 (International) or via email at sdahl@danielstrading.com. I welcome the opportunity to help you get started.

We also invite you to visit <http://www.danielstrading.com> to browse our featured systems in the "Strategies" section of the Daniels Trading website.

ABOUT DANIELS TRADING

Daniels Trading was established in 1995 by Andy Daniels, renowned grain trader and the firm Founder and CEO. The firm is conveniently located in downtown Chicago, just blocks from the exchanges. Daniels Trading offers a wide array of brokerage services including automated system execution, broker-assisted execution, online trading. Daniels Trading provides comprehensive trading resources such as free quotes & charts, market research, news, and ongoing education.

ABOUT THE AUTHOR

With over a decade of first-hand experience in the trading system arena, Steve Dahl is regarded by industry peers as a respected go-to source on the topic of algorithm and automated trading. Steve has consulted thousands of investors in his tenure as a Senior Broker at Daniels Trading in Chicago.

DISCLAIMER

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE. THE RISK OF LOSS IN TRADING FUTURES CONTRACTS OR COMMODITY OPTIONS CAN BE SUBSTANTIAL, AND THEREFORE INVESTORS SHOULD UNDERSTAND THE RISKS INVOLVED IN TAKING LEVERAGED POSITIONS AND MUST ASSUME RESPONSIBILITY FOR THE RISKS ASSOCIATED WITH SUCH INVESTMENTS AND FOR THEIR RESULTS.

