FUTURES TRADING SIMPLIFIED

How to Gain Confidence &
Learn the Process of Trading

By: Timothy Chilleri & Scott Hoffman

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FUTURES TRADING SIMPLIFIED: HOW TO GAIN CONFIDENCE & LEARN THE PROCESS OF TRADING

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This guide is intended to be a practical, interactive overview to futures trading. While we will cover many facets of futures trading, there are several hyperlinks throughout the guide serving as a jump off point to locate more in-depth information about a particular subject.

The guide will cover five areas:

1. How to Gain Knowledge and Confidence to Begin Trading
2. The Trade: From the Beginning
3. The Trade: Construction
4. The Trade: Execution
5. The Trade: Wrap-Up and Post-Thoughts

We will follow Bill, a fictional client of Daniels Trading, from his initial interest in futures, his thought process from the initial trade idea, the actual trade execution, risk management and wrap-up. We hope this gives you the blueprint to approach trading and serves as a jump point to learn more in-depth aspects of the futures market.

HOW TO GAIN KNOWLEDGE AND CONFIDENCE TO BEGIN TRADING

Our fictional client Bill is a 44-year old engineer who has always been interested in the markets. Bill first started trading stocks and mutual funds. As his knowledge and experience grew, he began trading ETF’s to diversify his portfolio. Some time ago Bill was introduced to futures through Jim, his co-worker. Jim already traded in futures and told Bill about futures as a way to directly trade many of the markets he has an interest: the grains (e.g., corn, wheat, and soybeans), metals (e.g., gold, silver), and exchange rates (currency futures) among other markets.
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These circumstances make Bill interested in learning more about the futures markets and he’s intrigued by the idea of trading them. But, as he doesn’t know much about the futures markets, he lacks comfort with the entire process. This awareness, coupled with the knowledge that he could lose money trading, leads Bill to the conclusion that he must first take time to do his homework and determine if trading in the futures markets is in fact a good fit for him.

Jim recommends that Bill check out the Daniels Trading website to learn more. To help him get a lay of the land, Bill first turns to “Futures Trading & You: 3 Things Every Investor Should Consider”, a 3-part video series on the Daniels Trading website.

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FUTURES TRADING & YOU

We believe there are three things every investor should consider prior to participating in the commodity futures markets. The videos included our “Futures Trading and You” series are intended to provide you with insight into these highly important topics. If you are interested in trading futures, we urge you to watch each video and explore how “risk/reward”, “gaining knowledge” and “choosing your commitment” are relevant to your own investing experience - you’ll be glad you did.

Bill is satisfied that he’s been given an honest assessment of the most important considerations relevant to learning and trading the futures markets. He reflects on the viewpoints and suggestions made in the videos concerning accepting risk/reward, gaining knowledge and choosing his level of commitment. Bill is ready to take the next step and feels confident that Daniels Trading can be a resource to help him learn the ropes and get started trading.

Bill turns once again to the Daniels Trading website and feeling more committed, watches the About Us video.

Bill likes what he sees and looks deeper into the website. He notices that there is plenty to assist a new trader. But with all of the guides, tools and information, he thinks a targeted approach to learning might be best for him. Knowing that he’s going to need some assistance and important oversight as he gets started trading, Bill decides to watch the video highlighting their Broker-Assisted Trading Service.
Once again, Bill is intrigued. He decides to escalate his interest beyond website perusal and calls Daniels Trading to speak with a broker and ask some questions. Bill is transferred to a broker and they have a very productive conversation. Bill shares details about his interest in the markets, as well as some of his questions and concerns. During the call, he is asked which parts of the Daniels Trading website he has reviewed. The broker then directs Bill to some key areas of the website while they’re on the phone together.

The broker explains that the CME Resource Center is a fantastic destination containing interactive content that will help Bill to learn more.

DT’s Futures Calculator helps Bill to understand how to calculate all-important profit/loss figures. The broker walks Bill through numerous calculations and Bill is excited to see how easy it is to use.
The broker explains to Bill that as a stock and ETF trader, much of his knowledge is immediately transferable over to the futures markets. Although he’s never thought of it before, Bill understands that in terms of Technical Analysis, a chart is a chart, whether it is Apple stock or corn futures. Bill also realizes that on the fundamental side of things, relevant supply/demand considerations are more directly reflected in the futures markets versus ETFs and other less linear, though currently trendy, instruments.

The broker highlights that important information needed for trading, such as quotes & charts, margins and contract specifications are all easily accessible via quick links on the top of the Daniels Trading website. He commits to showing Bill more about those when the time is right.

They also discuss Bill’s markets of interest and the types of research and information that will be available to him on a daily basis. Lastly, they hash out a specific plan for how Bill, with his broker’s experienced guidance, can become more comfortable with the markets, learn how to manage risk and reward and ultimately begin trading.

Bill hangs up very glad he made the call. He now has a much better understanding of what is involved and how things would work. Most importantly, he now has a solid plan for how to move forward. Based on his conversation, Bill decides it’s best to be relationship-focused and work one-on-one with his Daniels Trading broker to leverage the knowledge of a professional and ensure he places his orders correctly. He commits to doing his part to see this through.
Over the next few weeks, Bill has several conversations with his broker and he makes good progress. Although he has had to use his time wisely to progress, he’s actually surprised at how much he already knew and how easily things came to him once he took the time to actually focus on the important first steps. He recollects his 1st conversation with his broker and how he was reassured that together they faced a molehill, not a mountain, and he chuckled to himself that although he didn’t believe his broker at the time, he now saw that he was right.

Bill feels that he is getting very close to actually trading these markets that he finds so interesting. He reviews the “Why I Chose Daniels Trading” section of the website.

He scans the responses and realizes that they reflect the exact experience he has had with his broker contact. He finds that extremely compelling and it gives him a final measure of comfort that he’s in good hands.

Fueled by the confidence he has gained by everything he has learned, along with a strong sense of the opportunities available in the markets and how he can work with his broker to manage risk, Bill decides that he’s ready to move forward and open his live trading account. His broker walks him through the process on the Daniels Trading website.

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WHY I CHOSE DANIELS TRADING
Daniels Trading would love to work with you as a client. To earn your choice, our intentions are to be distinct, relevant and valuable to you and your trading needs. But don’t take our word for it. The most exclusive opinions we can provide are from our own customers. So here are their responses to “Why I Chose Daniels Trading.” We look forward to working with you.

OPENING AN ACCOUNT
We’re here to help you. Daniels Trading prides itself on its ability to provide multiple choices of products and clearing firms to its customers. After a consultation with a Daniels Trading representative, you should have a clear understanding of which clearing firm will be best to meet your needs.
Bill completes an account application providing some basic financial information so that the clearing firm knows that futures are a suitable investment for him and understands the risks of futures trading. When his account application is completed and his account is approved by the clearing firm, Bill deposits $18,000 in his new trading account. Bill understands that his $18,000 is risk capital that he can lose. All of Bill’s activity in his account is recorded and emailed to him daily, from depositing/withdrawing funds to trades executed, open trades and mark-to-market accounting.

**THE TRADE: FROM THE BEGINNING**

During the rest of this guide, things are described from Bill’s perspective. His Daniels Trading broker is available and helps him every step of the way.

Bill thinks the price of corn futures will go higher (rally) over the next several trading sessions.

Bill uses the research available to him through Daniels Trading to get more information about the corn market. He uses the “Insider Market Advisory” (IMA) to get analysis and insight in the corn futures market. The IMA covers all sectors of the futures markets, from stock indices to grains to Forex to precious metals, providing Bill with fundamental factors to consider and technical analysis including support/resistance areas. It is a core piece of research that Bill is able to access every day. The IMA gives him an overview of every futures market he follows.

Additionally Bill reviews the Daniels Ag Advisory (DAA). The DAA is emailed to him on a daily basis providing the insights of Andy Daniels, founder of Daniels Trading and a renowned grain trader, on the grain markets.

Based on this information, Bill decides he will buy or “go long” corn futures. He checks the last traded price and other relevant data such as volume and open interest. Learn more about these complimentary services at Daniels Trading below.
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INSIDER MARKET ADVISORY
This premier trade advisory service is designed to provide you with the timely information your trading depends on.

DANIELS AG ADVISORY
Published by the founder of Daniels Trading, this newsletter focuses exclusively on the grain markets and provides you with real-time advice from an expert with well over 20 years of day-to-day trading experience.

QUOTES + CHARTS
Complete market data and enhanced features such as key technical numbers. Create your own Custom Quote Portfolio to enhance your futures trading experience! Store up to 15 quotes on the markets you watch most without entering symbols.

THE TRADE: CONSTRUCTION

Bill begins to formulate his trade. First, which futures contract month will Bill trade in? Bill likes to trade the “front month” contract, the contract month where the most trading occurs, providing the greatest liquidity. Liquidity is a measure of how easy it is to get in and out of the market. The more traders and trading volume a contract has the more liquid it is. Since the front month is currently the March 2011 contract, he decides he will trade the March 2011 Corn contract, ZCH1. (“ZC” represents the corn contract that trades on the electronic GLOBEX exchange, “H” represents the contract month of March, and “1” represents 2011).

How many contracts should Bill buy? Bill wants to ensure his position size is appropriate for his account size and that his risk is within his risk tolerance threshold. In order to figure out how many contracts to trade he will have to compute some numbers.
First, how much capital is required for initial margin of the position? He plans on holding his trade “overnight” - through the close and into the next session (and possibly beyond). This means he will need the overnight initial margin to hold the position. He looks up initial margin for corn.

Initial margin for corn is $2,025 per contract. Bill knows that the margin requirement for his trade isn’t taken from his account. It is simply considered to be “pledged” so Bill can make good on his trade if he takes a loss. Margin ensures that losing traders will have sufficient funds to pay the winners.

Bill decides he will trade one contract on this trade.

Bill knows each “tick” in corn (a “tick” is a market’s minimum fluctuation) is $0.0025 of a penny. A “tick” in corn ($0.0025) results in $12.50 profit/loss per contract that Bill holds. This means if corn moves one penny ($0.01), Bill will make or lose $50 per futures contract ($12.50 x 4 ticks/penny). Since Bill decides he will buy one contract, he will be making or losing $50 for every penny corn goes up or down.

Now, he must decide his entry price: corn is currently trading at $4.2800 per bushel (bu). Bill decides he wants to buy corn at $4.2800/bu. Bills knows it is important to figure out how much he is willing to risk versus what he think he can gain. This is known as his risk to reward ratio. Bill knows that many traders believe they should take a trade only if they can make at least 3 to 1 on his money. This means that if he is willing to risk $1 he expects to make $3 if the trade is successful.
Bill determines his “stop loss” using one or two methods. 1) What is the maximum financial loss (pain) Bill wants to take if he is wrong and the trade goes against him? 2) Is there a technical level (on the price charts) that would indicate that Bill’s analysis might be wrong and it is likely that the market would continue to move against him? (The latter incorporates technical analysis.)

He decides that he will risk $600 total (before commissions and fees) as his maximum loss (pain) threshold. Where does this put the price of corn? He calculates it using the futures calculator.

He calculates that if the price of corn goes to $4.1600, he would lose $600 (before commissions and fees). Since Bill would lose a total of $50 for each penny his position would move against him, Bill can risk 12 cents per bushel per contract (again, before commissions and fees). Bill knows that his initial stop loss is a better measure of his risk than the margin required. A trader doesn’t have to risk the full margin amount on a trade; he can choose to liquidate a trade at almost any time after he has entered it. A stop loss doesn’t guarantee that Bill’s loss would be limited exactly to his stop point, but in liquid markets a stop loss will help limit a trader’s loss to roughly what he has planned.

Bill is trying to keep his risk to reward ratio at 3 to 1 for this trade. Since he is willing to risk 12 cents on this trade, he is trying to collect 36 cents or $1,800 on this trade. Remember, each penny move in his favor equals $50. Since he thinks it is possible for corn to trade up 36 cents and is comfortable risking 12 cents, he is ready to put on the trade.
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There are two general approaches to liquidate a trade. First, a trader can pick a profit target for a trade; a point at which he believes the market will stop moving in his favor. If he feels there is such a price he may look to liquidate his trade at this price.

The other school of thought is that instead of picking a point to pick where to liquidate a trade, the trader adjusts his stop loss to reduce his risk then to lock in profit as the trade moves in his favor. This allows the trader to continue to profit if it keeps moving in his favor.

Which of these should you use? Exiting a trade is often the most difficult decision to make when trading. If you pick a profit target and exit when the market gets to it, you forgo additional profit if the market keeps moving in your favor. If you choose to trail your stop loss and not use profit targets you will always end up giving back some profit as the market retraces to your stop loss. Realize there’s no one right answer to this question. Make sure you are consistent and conscientious in your approach, and keep records of your trades. Over time you’ll figure out which approach works best for you, or maybe you will end up using different approaches in different situations.

Since March Corn is currently trading at $4.2800 and he wants to buy at $4.2800 he can use a Market order (buys at the asking price) or a buy limit order (buy at a specified price or better). Bill decides to use a buy limit order, so he can buy at $4.2800 or better. Since Bill is unsure if he will be able to buy at the price he wants during today’s session, he makes his order “good-til-cancelled” or GTC. Bill learned about the types of orders he can use like buy limits and “order flags” like GTC using Daniels Trading’s Order Entry Handbook.

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ORDER ENTRY HANDBOOK
Our Order Entry Handbook provides a complete description of all types of futures orders, how they are executed and which are accepted by our member exchanges.

Bill wants to make sure he knows how to place his trade but he also knows he can talk to his Daniels Trading broker to make sure that the order for his trade is entered as he planned. Bill has now thought through all aspects of his trade: he knows what commodity he wants to buy/sell, what month and year, the price, the risk, the reward, and some ratios to put his overall risk and reward into perspective. He is now ready to place his trade and calls his broker.
THE TRADE: EXECUTION

Bill calls his Daniels Trading broker to place his order.

Bill: “Hello, today I would like to buy corn. I want to buy one contract of March 2011 Corn on a Limit Order of $4.2800 or better, “good-til-cancelled”.

DT Broker: “Bill, understood. You want to buy one contract of March Corn at $4.2800 on a limit, GTC, is this correct?” (Please note that commissions and fees are always involved in live trading and are not included in this fictional example).

Bill: “Yes, correct.” Bill listens carefully when his broker repeats the order back to make sure that he gave the correct order and that his broker took the order correctly.

When Bill did his analysis of the trade, he decided to risk a maximum of $600. This means that Bill would exit the trade and sell his one contract of March Corn if he lost $600. He tells his broker:

Bill: “If I buy one March Corn, I would like to work a sell stop and sell limit to set risk and reward parameters.”

DT Broker: “Sure, where would you like to work these orders?”

Bill: “I want to place a “sell stop” for one contract at $4.1600 per bushel. GTC. This means I am risking $600 per contract correct?”

DT Broker: “Yes. You are risking 12 cents, or $600 per contract, so that’s $600 total.”

Bill: “Great. I want to take profits if I make a total of $1,800. Please place a sell limit order at $4.6400 GTC for one March Corn contract.”

DT Broker: “Sure. To confirm, you are working a sell stop for one March corn contract at $4.1600 GTC and a sell limit order for one contract at $4.6400 GTC.”

Bill will now wait to see if he receives a “fill” (his order is executed giving him a long position in March corn). In order to receive a fill, another trader must sell him one at the agreed price of $4.2800. The following morning March Corn trades at his entry price at 4.2800 and his order is filled. Bill’s broker calls him to report his fill.
Turner Breakout Reversal (TBR)

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DT Broker: “Bill, you bought one March corn contract at your price, $4.2800. You currently are working a sell stop at $4.1600 GTC and a sell limit at 4.6400 GTC.”

Bill is now “long” one March Corn contract. That night, the clearing firm sends him a statement confirming his purchase and detailing commissions and fees charged for this trade. Bill’s broker reiterates that it is very important that Bill check his statement and contact his broker if he ever has any questions of sees any discrepancies. Bill knows this is important because he remembers reading about it in the account forms.

Also, Bill’s broker has given him access to tools that will allow him to monitor his account and positions in real-time while the markets are trading. Bill likes this transparency and the security it gives him given the risks involved in trading. Bill enjoys using this tool and watching his positions move when he has the time during the day.

Days pass as corn prices move up and down. Every night Bill’s position is “marked to market”. This means that as the market moves in his favor money is credited to his futures account nightly; as the market moves against him money is debited from his account on a nightly basis. Seven days later the March Corn trades up to his price target at 4.6400 and his contract is sold out for a profit.

DT Broker: “Bill, great trade. We hit your sell limit today. You sold one contract of March Corn at your price of $4.6400. You earned $1,800 before commissions and exchange fees. Your account value is now valued at $19,800”.

Bill: “Thanks. Hopefully I can keep stringing some winning trades together! Now that I’m out of this trade please remember to cancel my stop loss order.”

THE TRADE: WRAP-UP AND POST-THOUGHTS

Bill logs his trade to keep track of his trading results.

By tracking every trade, he keeps an active log of his successful and unsuccessful trades. Bill knows that in order to keep improving, he must study how he has traded and where he makes good or bad decisions. Did he take profits where he planned? Did he get emotional and change his plan mid trade? Traders who are always looking to improve go through these exercises to learn about their own strengths and weaknesses.
While Bill is thrilled with his $1,800 winning trade, he knows he must respect the market and not let hubris keep him from making poor trading or risk management decisions. Bill reviews Daniels Trading’s Commodity News on the markets to look for other trade ideas.

To broaden his trading knowledge, Bill utilizes Daniels Trading’s extensive education and support network. He regularly views webinars, reads the Daniels Trading blog, and keeping up with trading articles and special futures research report through the dt Futures Newsletter.
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COMMODITY NEWS
Follow our breaking new stories and get a unique take on current events that may impact the commodity futures markets. Multiple new articles are posted each weekday. Receive real-time updates with our RSS feed, follow us on Twitter @DanielsTrading, become a fan on Facebook to stay informed.

DT FUTURES NEWSLETTER
The dt Futures Newsletter delivers featured market information and specific trade strategies directly to your inbox. Published semi-monthly, it is designed to help traders of all levels accomplish their trading goals. Subscribe Today - It’s FREE!

WEBINARS
We are taking an extra step to educate our customers through the use of webinars. Each week, there will be multiple webinars conducted by our knowledgeable futures brokers. These webinars will cover a variety of topics, including our online futures trading platforms, swing trading, technical analysis, fundamental analysis and much more! All interested in futures trading are encouraged to attend.

BLOG
The dt Futures Blog is a great place to learn about commodity futures trading and investing. Insightful educationally-focused articles on topics ranging from choosing a futures broker to trading strategies and risk management are published frequently.
Bill re-starts the cycle of thinking about a new trade and how he can effectively and prudently use his risk capital.

We hope this guide serves as a step-by-step guide to the nuts and bolts of futures trading and how Daniels Trading can give futures traders and prospective traders the tools to make informed trading decisions. You should now have a better understanding of what it is like to research and place a trade and some ideas on how to manage a trade once entered. While this is only a short guide, we hope this will serve as a starting point to the Daniels Trading website. There you can access more in-depth guides and study materials.

We invite you to contact your Daniels Trading representative who can listen to your needs and interests to help answer your questions and give you the knowledge and tools needed to reach your goals as a futures trader.

Happy trading!
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.

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