

Order Flow Dynamics

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Module 10 : Risk, Money & Trade Management

Disclaimer

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Many traders think money management is the key to success. Money management is important, but you must realize that not no two trades are exactly alike. That is where a lot of traders run into trouble with money management – they treat all trades the same. The problem is they are over focused on the financial risk of the trade and stop thinking about what is happening in the market. In many cases it gives a trader a false security as it removes them from the market.

“My testing has shown that this is a 69.2% winning trade with an average profit of 3r and a loss of 1r.”

Losing traders think in certainties.

Successful traders think in probabilities.

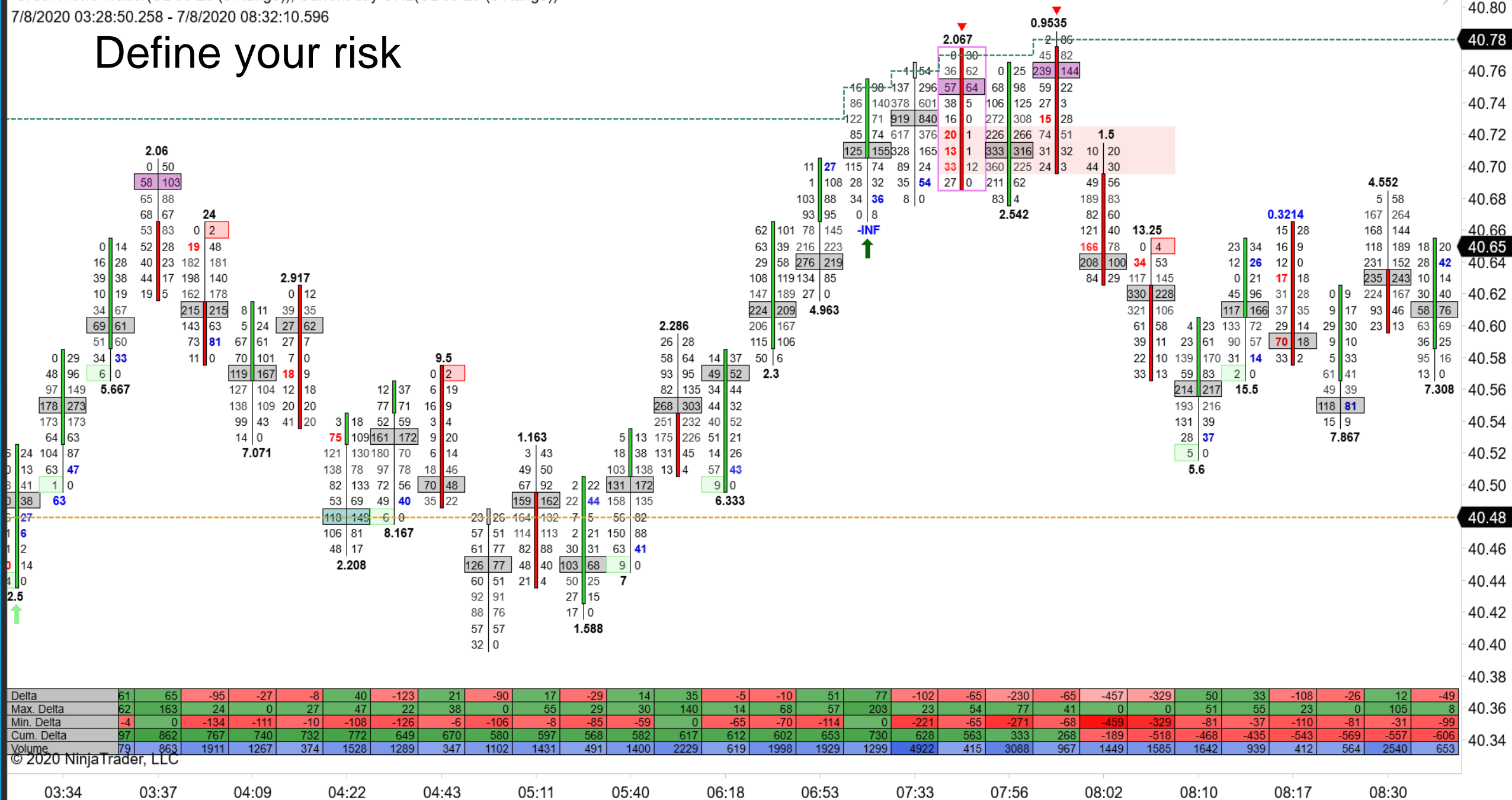
When you have an edge, but you don't take trades, your edge quickly disappears because you are trading your trading method and the few trades you don't take can be the difference between success and failure.

The only true factor of trading that a trader has control over is the protective stop level. It is one of the most, if not the most important part of trading. The profit potential of any trade can never be accurately defined. Profit potential is an expectation or hope.

You can define how much you want to lose on a trade, but you can never define potential profit.

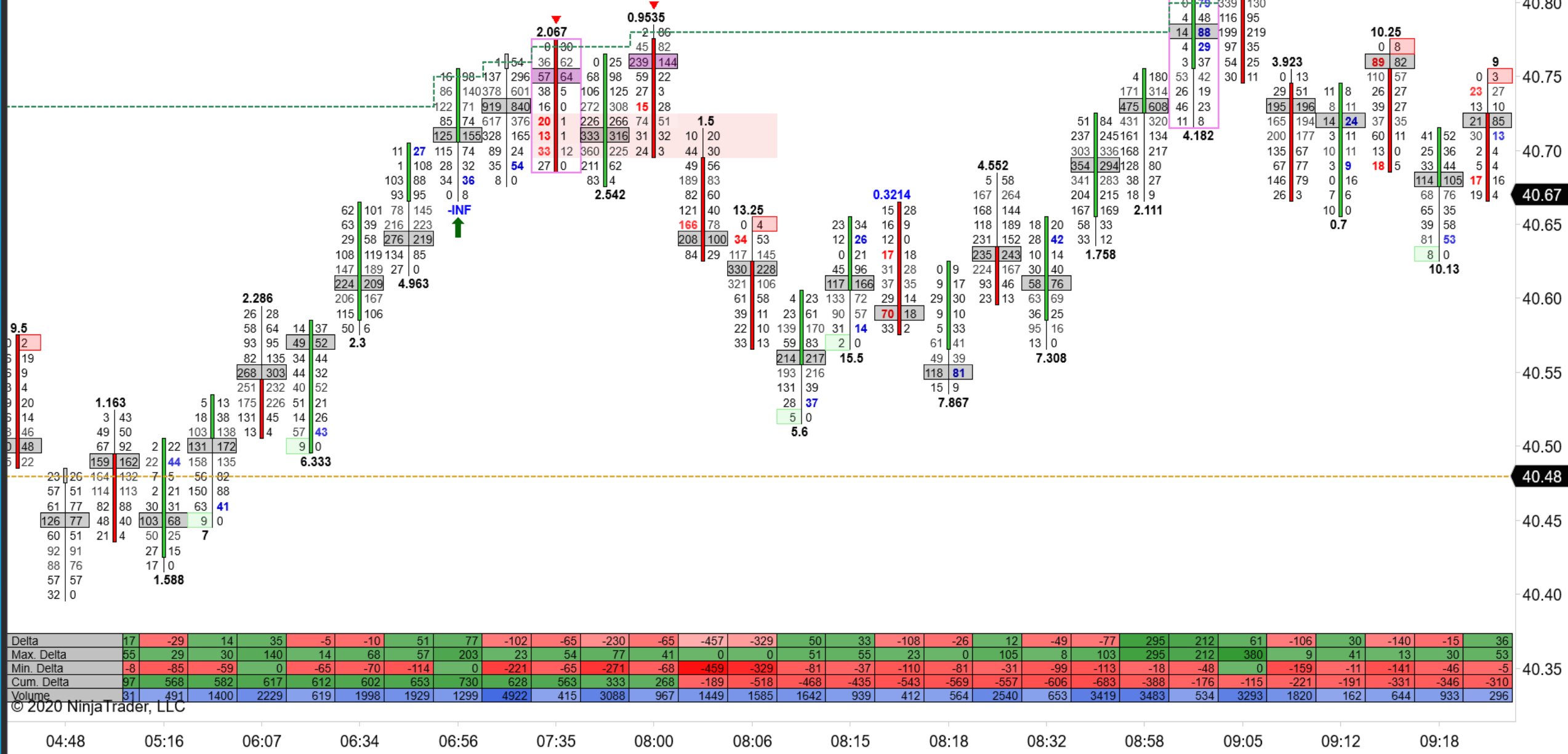
7/8/2020 03:28:50.258 - 7/8/2020 08:32:10.596

Define your risk



7/8/2020 04:43:14.113 - 7/8/2020 09:19:14.829

But can't make the market go to your take profit level



Difference between trade setups and trading plan.

A lot of traders fail because they think having a trading setup to look for is all they need to be successful. But a trade setup is just part of the over all trading plan. A trade setup allows you to take essentially the same trade over and over without much thinking. You still need to apply money management, risk management and trade management. A trade setup is the starting point to build your trading plan around.

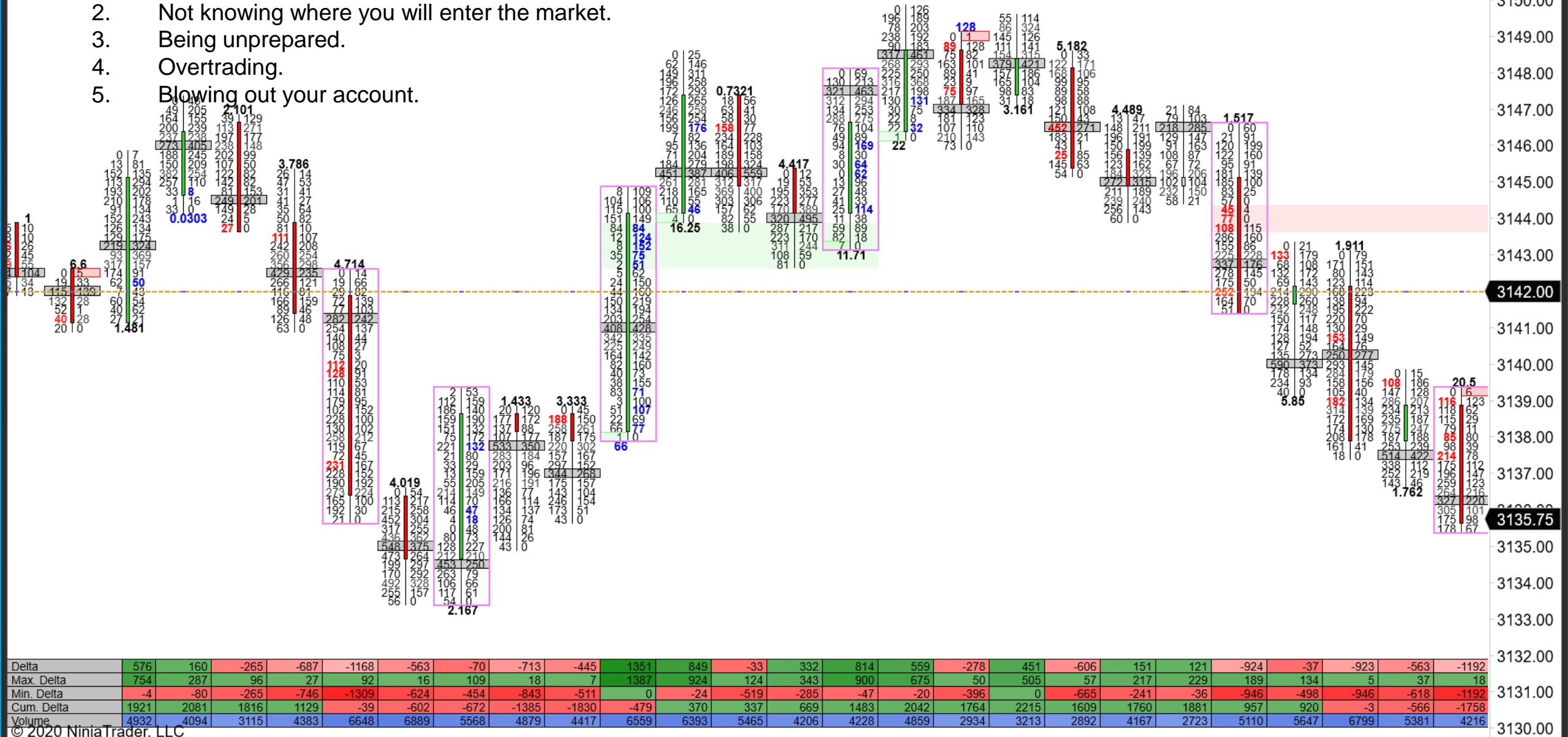
Building a trading plan around a trade setup stops you from:

1. Trading irrationally.
2. Not knowing where you will enter the market.
3. Being unprepared.
4. Overtrading.
5. Blowing out your account.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))

7/10/2020 08:29:00 - 7/10/2020 08:55:00

1. Trading irrationally.
2. Not knowing where you will enter the market.
3. Being unprepared.
4. Overtrading.
5. Blowing out your account.



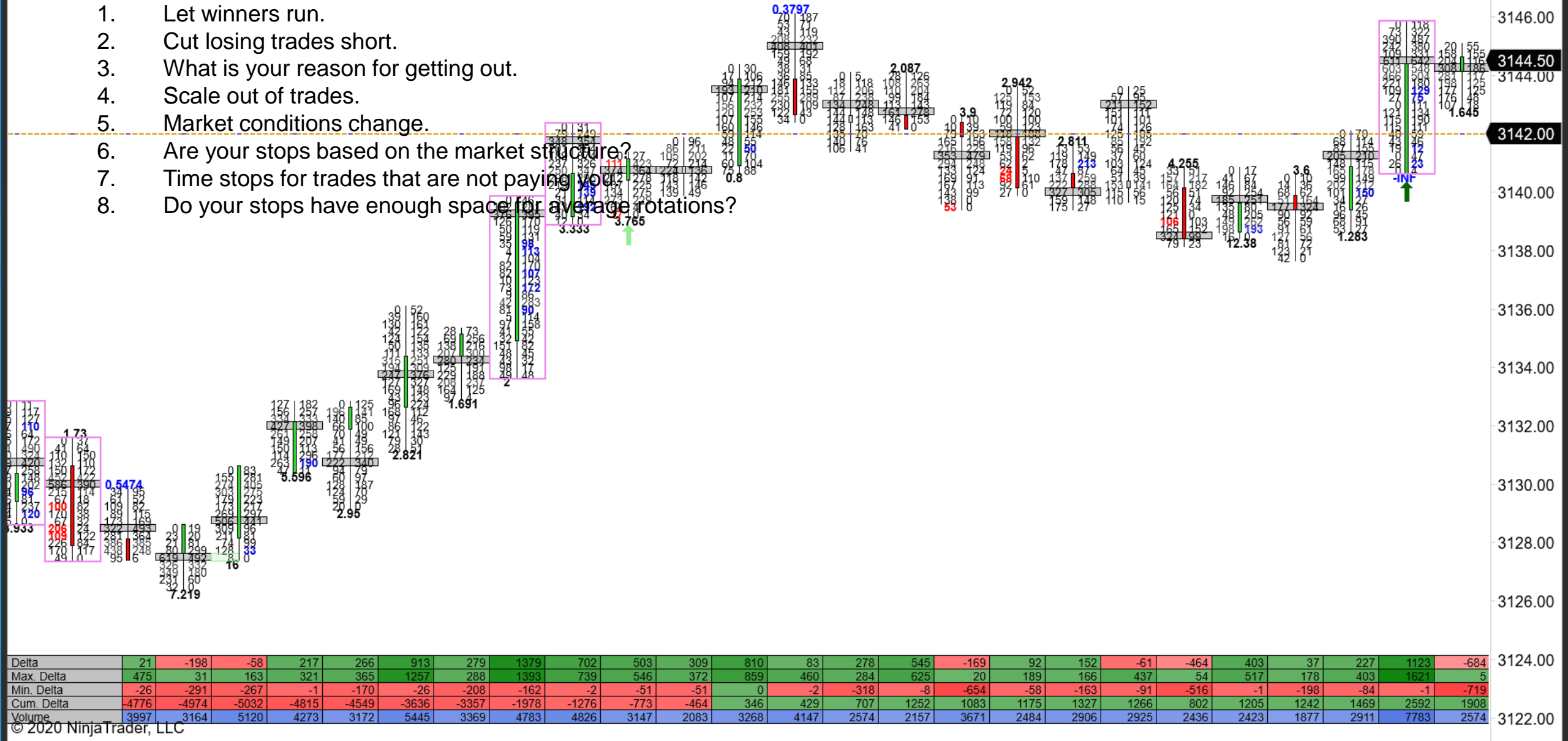
What is your exit strategy?

1. Let winners run.
2. Cut losing trades short.
3. What is your reason for getting out.
4. Scale out of trades.
5. Market conditions change.
6. Are your stops based on the market structure?
7. Time stops for trades that are not paying you.
8. Do your stops have enough space for average rotations?

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))
7/10/2020 09:02:00 - 7/10/2020 09:28:00

What is your exit strategy?

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Trade management mistakes.

1. No clear exit strategy.
2. Letting losing trades get ugly.
3. Taking profits early.
4. Getting greedy.
5. Stops too tight.
6. Moving stops as the market get close.
7. Stops too far.
8. Not getting out when it is time to get out.
9. Using same stop parameters for all markets and conditions.
10. Letting stops take over your market analysis.

High probability trades vs low probability trades.

Low probability trades have a high probability of failing. One of the many reason's traders blow up accounts is they don't let go of a bad trade and it follows them into their next trade.

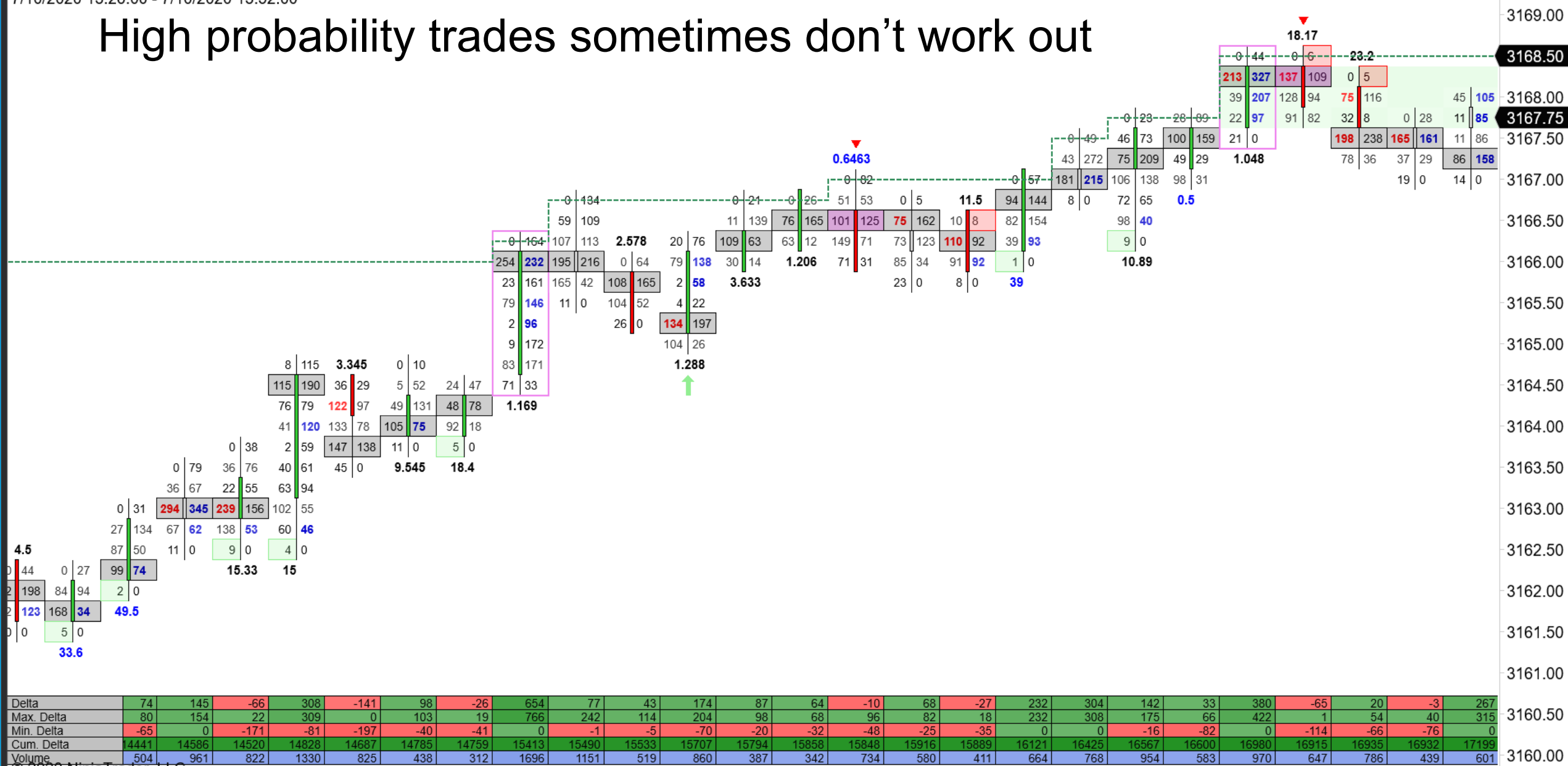
You need a reason for every trade you take. A trap many traders fall into is taking a trade and it loses, then immediately take another trade, often without reason, looking to make it back immediately. Don't be that trader. Often you hear a trader say, "I made a dumb mistake." That is often their dumb mistake.

A high probability trade does not mean you won't have losing trades. What it means is when you are wrong, the losses will be minimal, but the profit potential is very big.

Taking high probability trades requires patience and it requires a trader to not take unnecessary trades or risk.

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High probability trades sometimes don't work out



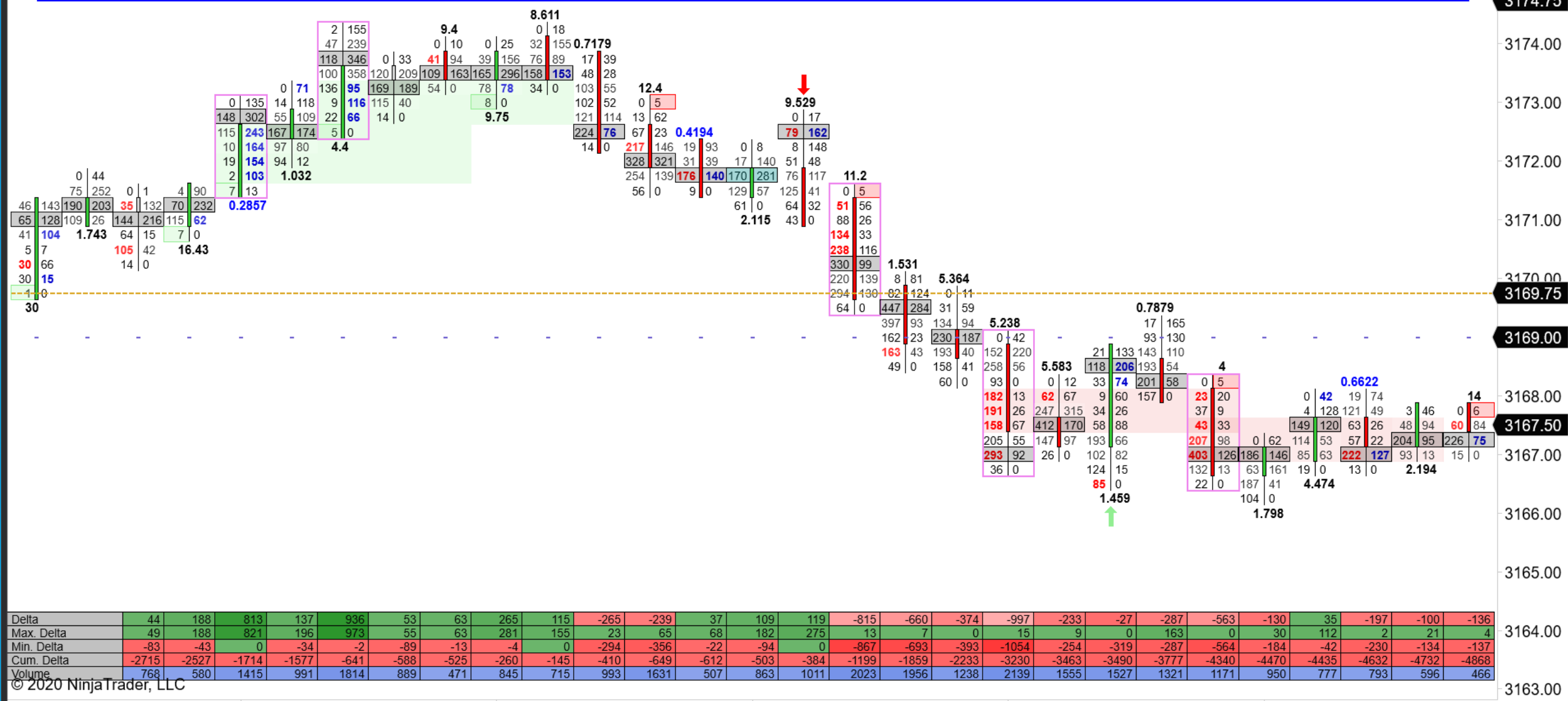
In trade analysis – when you are in a trade, you must monitor it order to maximize it.

- Is the trade working as planned? Or not?
- Is the trade moving towards the target? How close?
- Is the trade moving towards the stop? How close?
- How long has the trade been on?
- Did the trade get close to the target then back off?
- Should you get out early?

Active trade management and analysis while in a trade will allow you to make adjustments to help your bottom line.

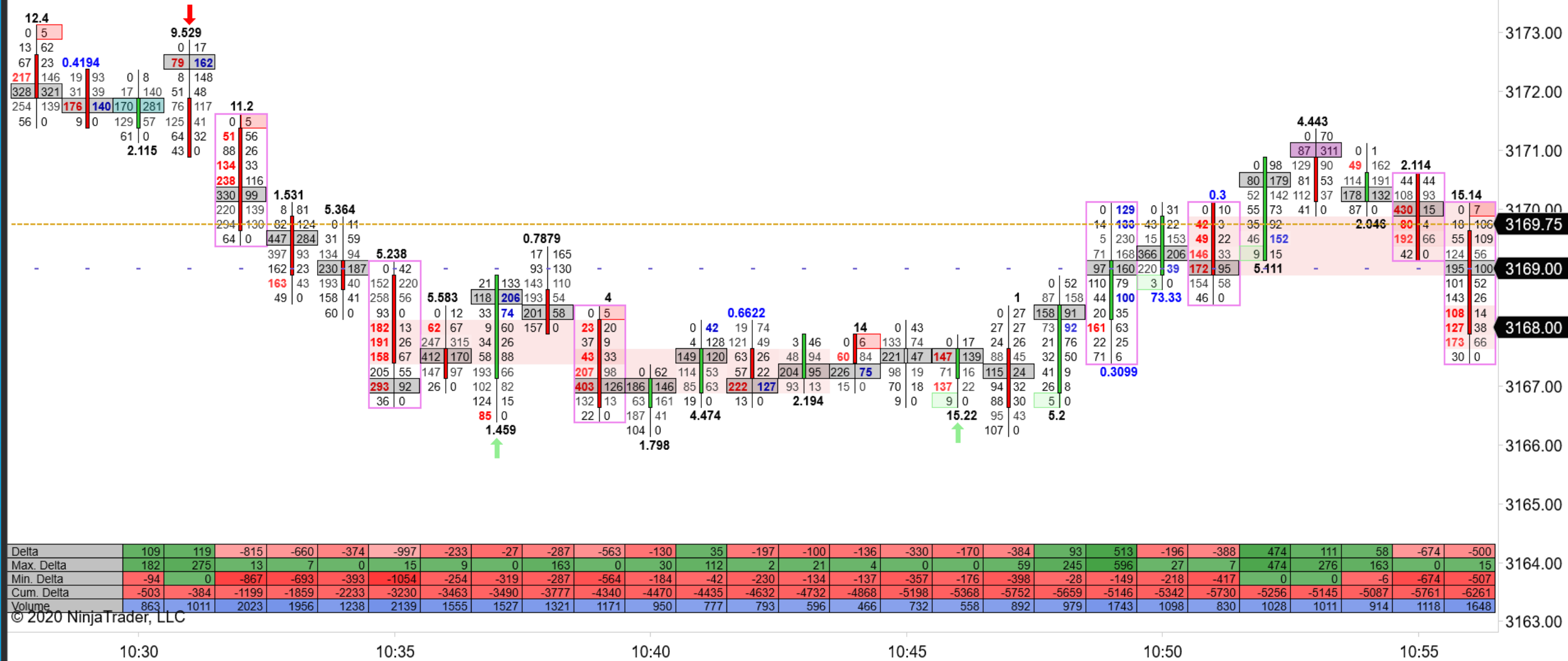
Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))
7/7/2020 10:16:00 - 7/7/2020 10:44:00

Layering in trade



Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))
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Layering in – managing the trade.



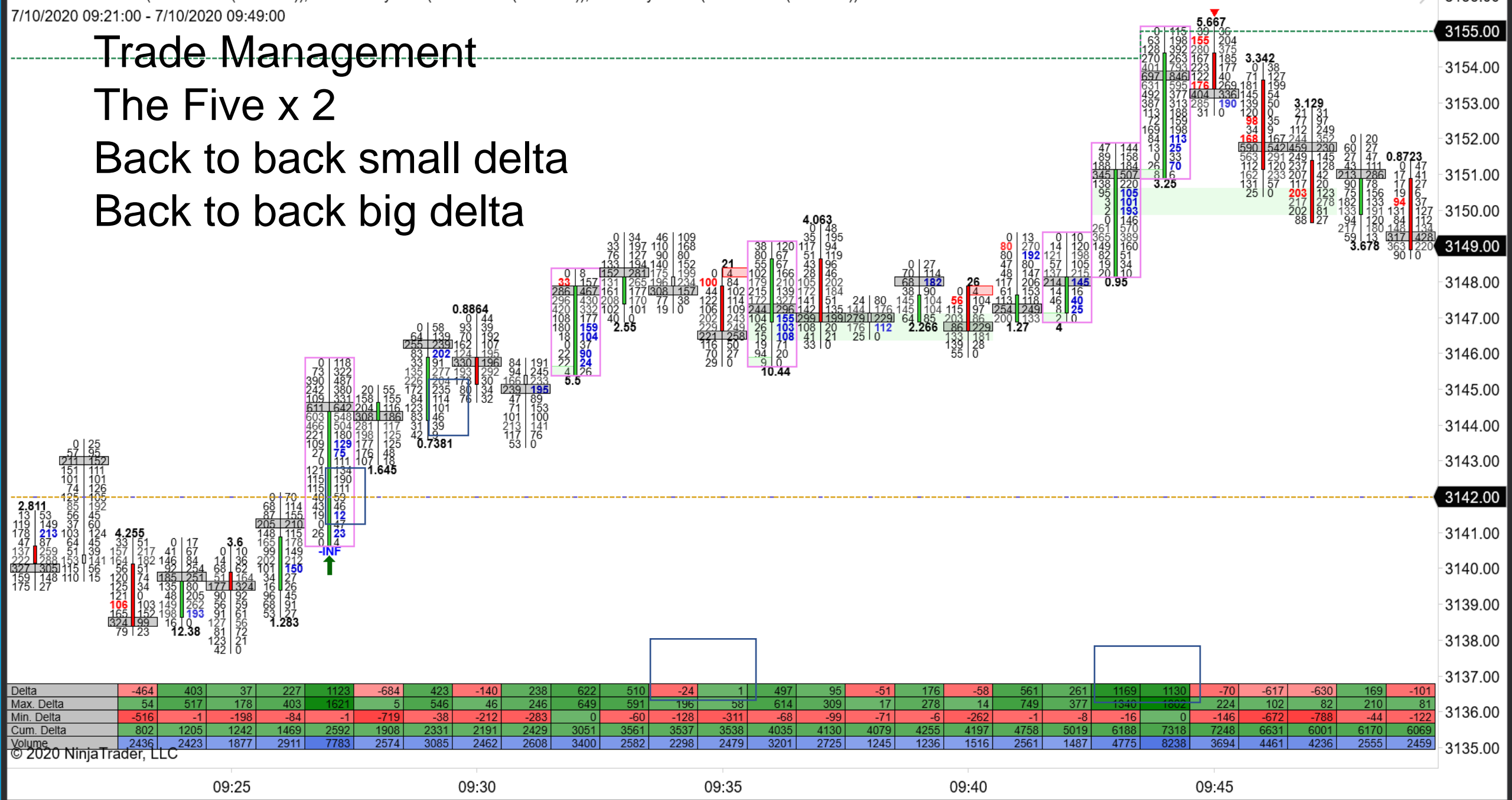
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Trade Management

The Five x 2

Back to back small delta

Back to back big delta

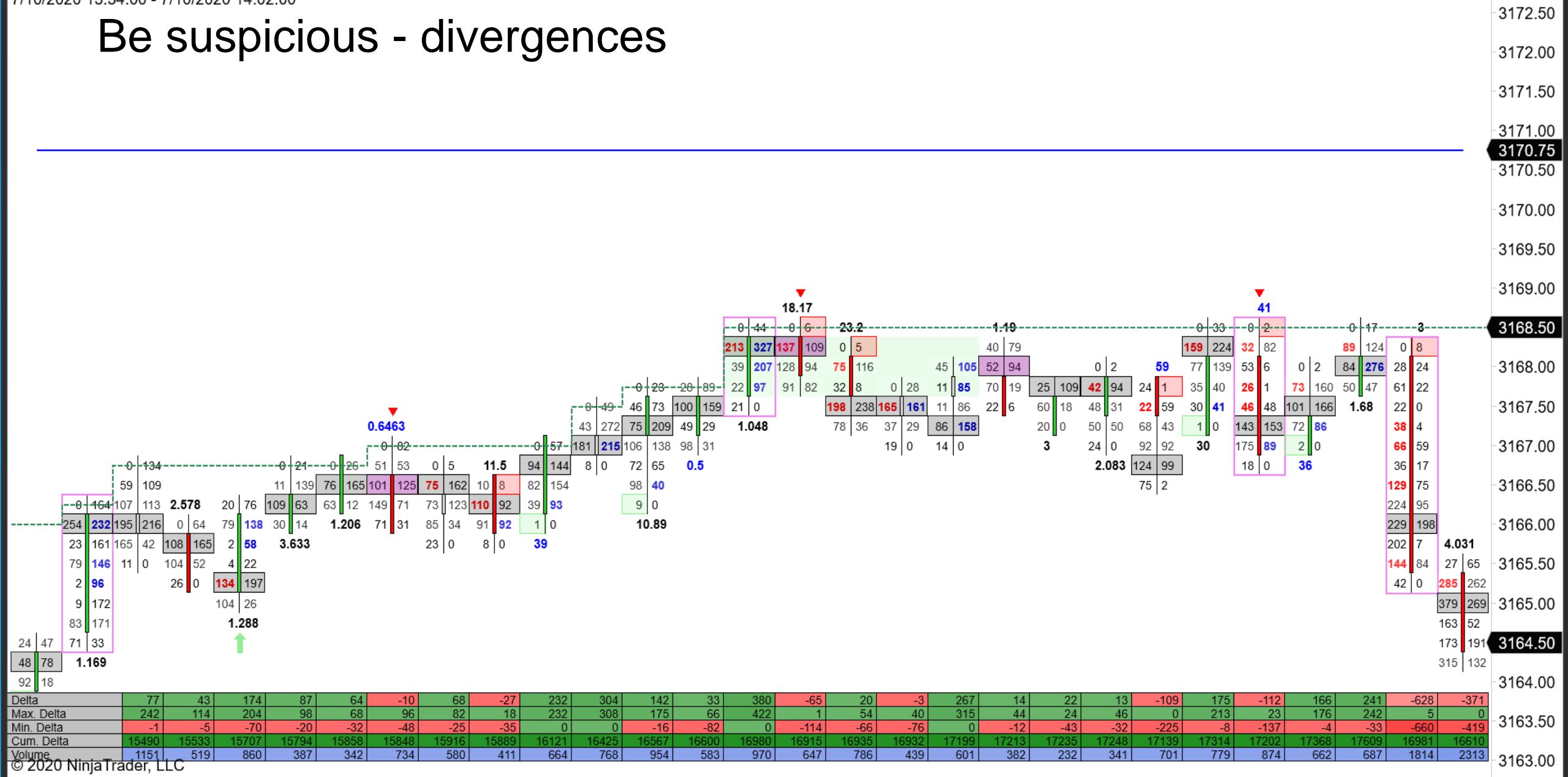


Trade monitoring – As soon as you get into a trade you want to start seeing the market move in your favor. If it does not, and instead immediately starts moving against you, you probably shouldn't be in the trade. This is the time a trader earns his living. You must be alert to quick moves, but you also must be suspicious of what is happening in the market.

What do I mean by suspicious? Think about it. Why did you get into a trade? You expect the market to either continue in its current direction or reverse its current direction. You made a trading decision based on current market conditions, but the market is not reacting the way it should this could be caused by an underlying change in market conditions.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))
7/10/2020 13:34:00 - 7/10/2020 14:02:00

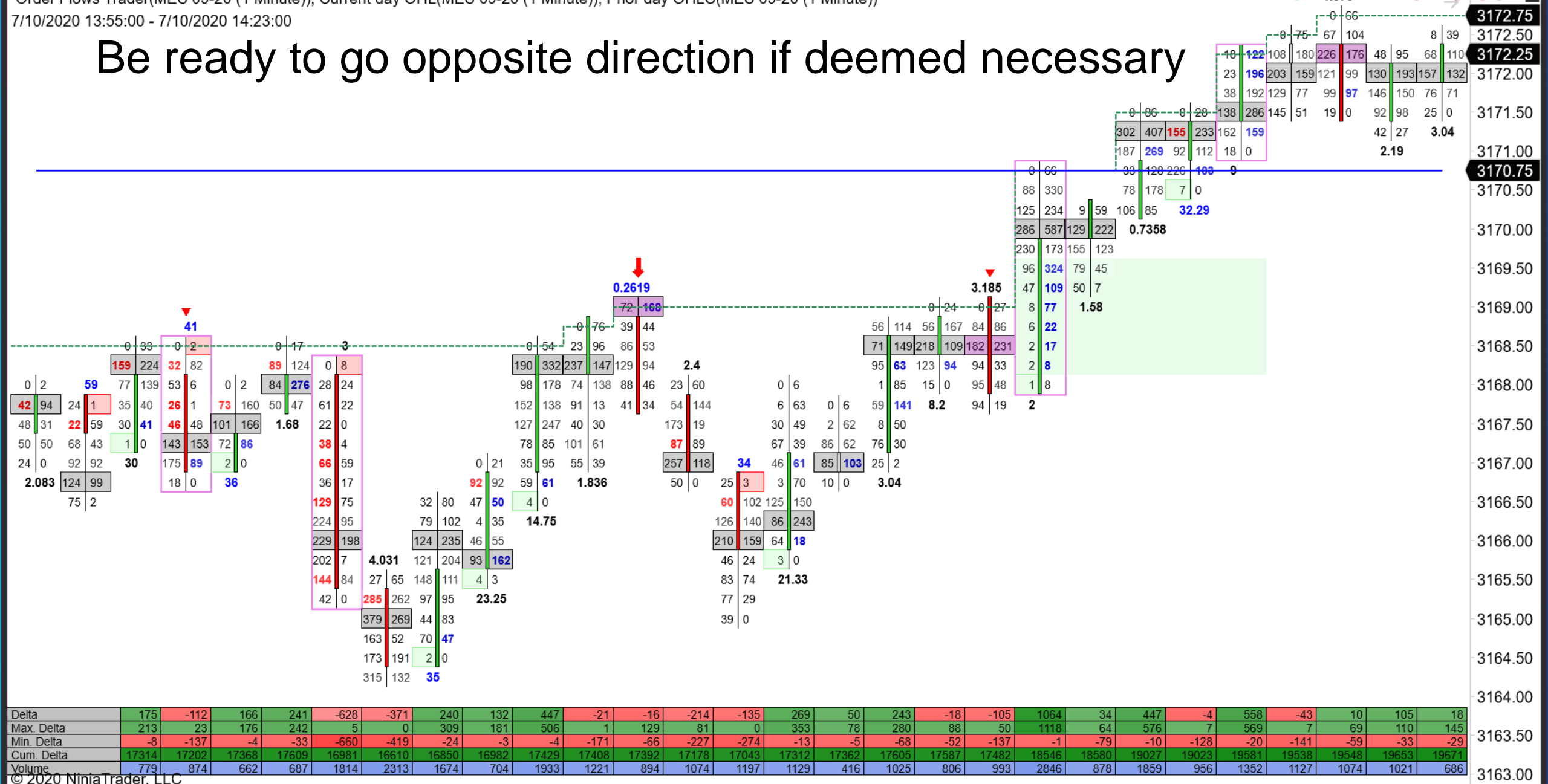
Be suspicious - divergences



Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute)), Prior day OHLC(MES 09-20 (1 Minute))

7/10/2020 13:55:00 - 7/10/2020 14:23:00

Be ready to go opposite direction if deemed necessary



Monitoring a trade gets tricky for many traders because they want to over analyze every tick when they don't need to do that. What you need to do is monitor the pulse of the market.

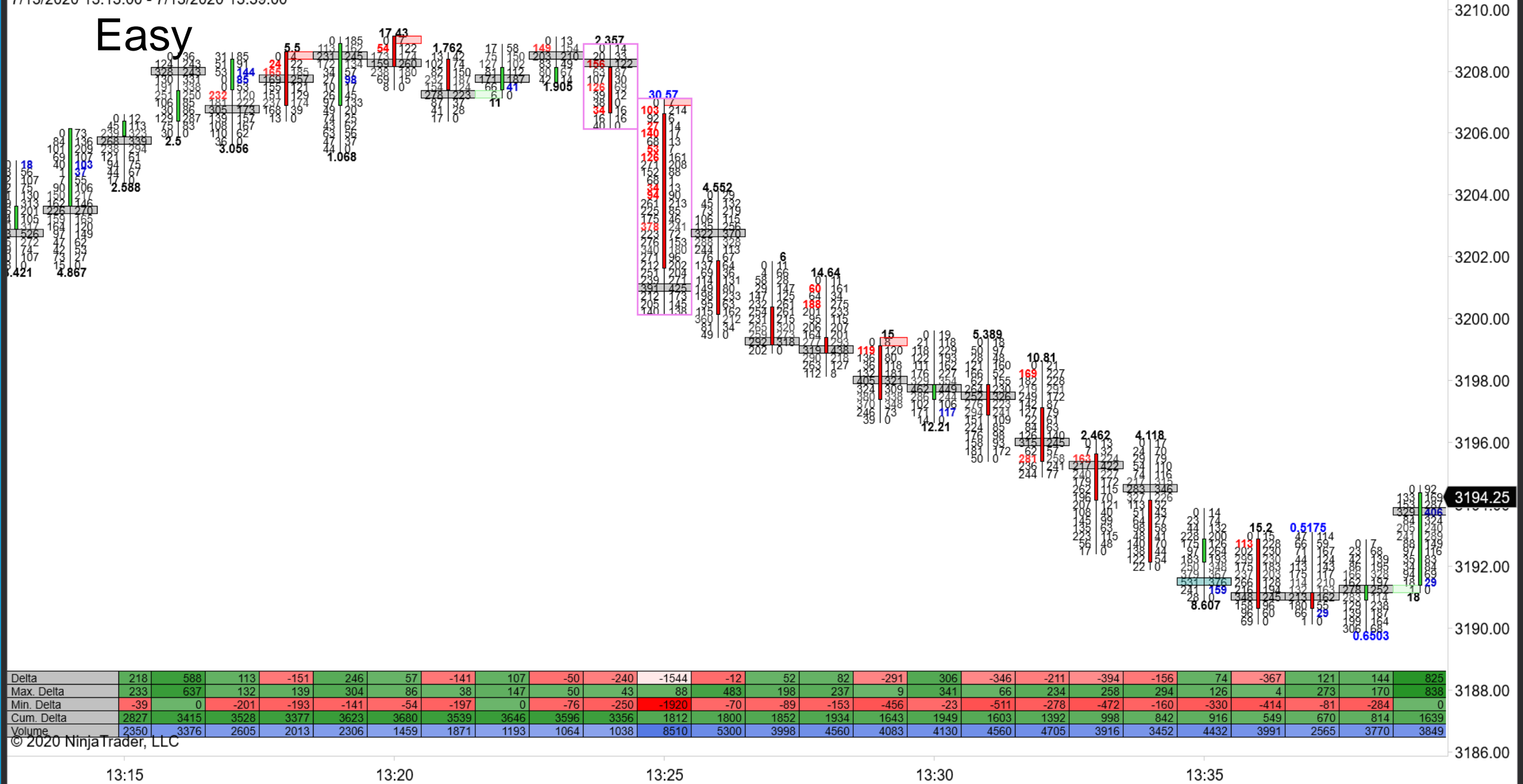
There are three conditions you can find yourself in after getting into a trade:

Easy – No problem, the market doing exactly what it should.

Neutral – Market spinning its wheels, not moving exactly as it should, based on the order flow, but still moving.

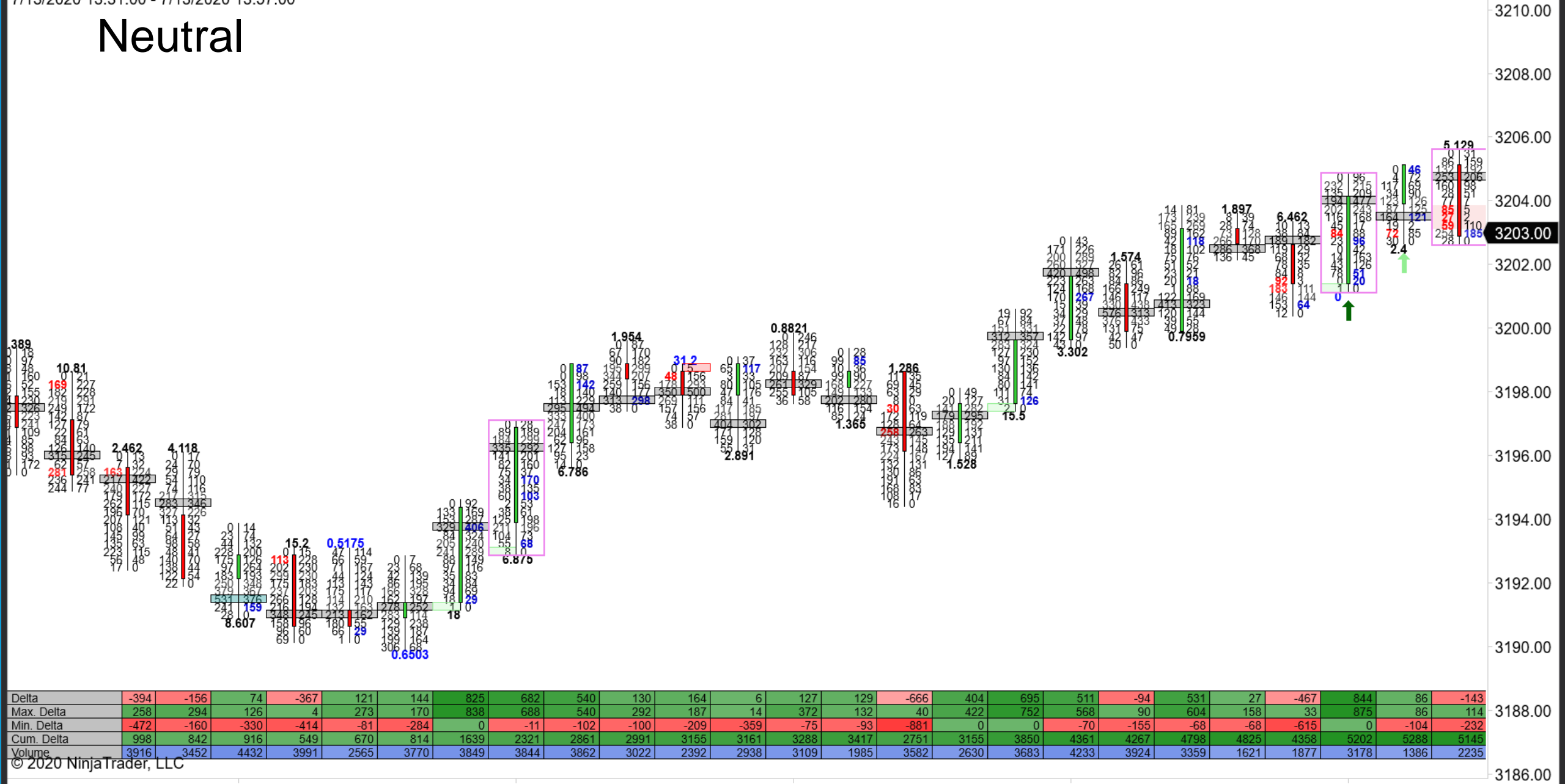
Difficult – immediately against you. Comes back to break even, then back against you. Bail out early.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))
7/13/2020 13:13:00 - 7/13/2020 13:39:00



Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))
7/13/2020 13:31:00 - 7/13/2020 13:57:00

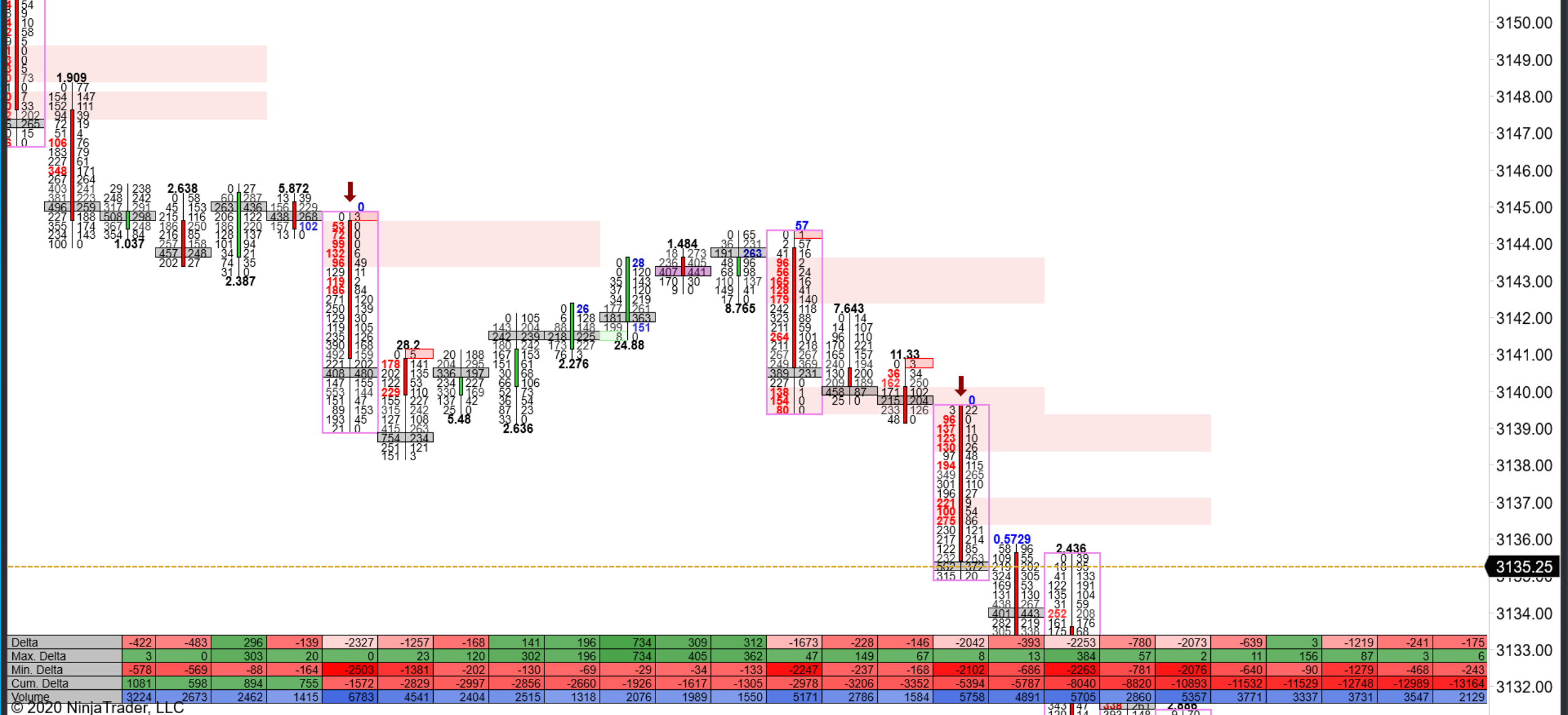
Neutral



Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))

7/8/2020 10:02:00 - 7/8/2020 10:28:00

Difficult



Delta	-422	-483	296	-139	-2327	-1257	-168	141	196	734	309	312	-1673	-228	-146	-2042	-393	-2253	-780	-2073	-639	3	-1219	-241	-175
Max. Delta	3	0	303	20	0	23	120	302	196	734	405	362	47	149	67	8	13	384	57	2	11	156	87	3	6
Min. Delta	-578	-569	-88	-164	-2503	-1381	-202	-130	-69	-29	-34	-133	-2247	-237	-168	-2102	-686	-2263	-781	-2076	-640	-90	-1279	-468	-243
Cum. Delta	1081	598	894	755	-1572	-2829	-2997	-2856	-2660	-1926	-1617	-1305	-2978	-3206	-3352	-5394	-5787	-8040	-8820	-10893	-11532	-11529	-12748	-12989	-13164
Volume	3224	2673	2462	1415	6783	4541	2404	2515	1318	2076	1989	1550	5171	2786	1584	5758	4891	5705	2860	5357	3771	3337	3731	3547	2129

Trade management is a form of risk management. If a trade is in the easy stage, then that is good. The market is moving in your favor. You can choose to add to the position. If a trade is in the neutral stage, you can reduce your position, tighten your stop. If a trade is in the difficult stage the market is acting unexpectedly or you have become uncertain of the current market condition, then you should seriously consider getting out of the position.

Market can go from neutral to difficult fast.

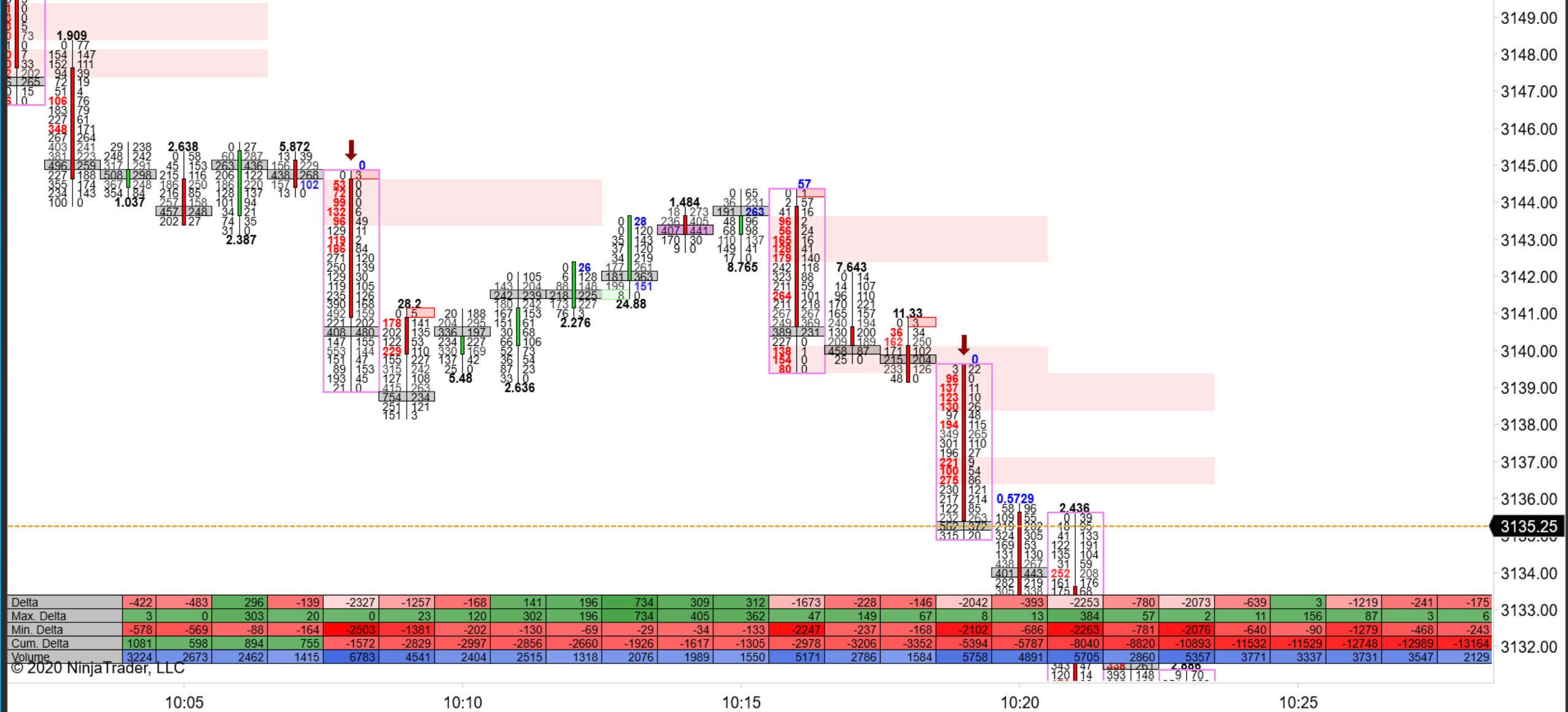
Reasons for getting out of a trade early for a loss:

1. If the market is not moving in your direction. Sounds simple. But is one of the most difficult decisions traders must make because it means you are taking a loss. I expect the market to move in my favor sooner rather than later. Depends on the trade setup as well. If I am buying a pull back, I expect a little heat, but if it is a momentum trade, then the market needs to move sooner rather than later. If the trade is against me for a prolonged period of time but hasn't stopped me out yet, as much as I hate to, I know I have to get out.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))

7/8/2020 10:02:00 - 7/8/2020 10:28:00

Get out early for a loss rather than let the market stop you out.

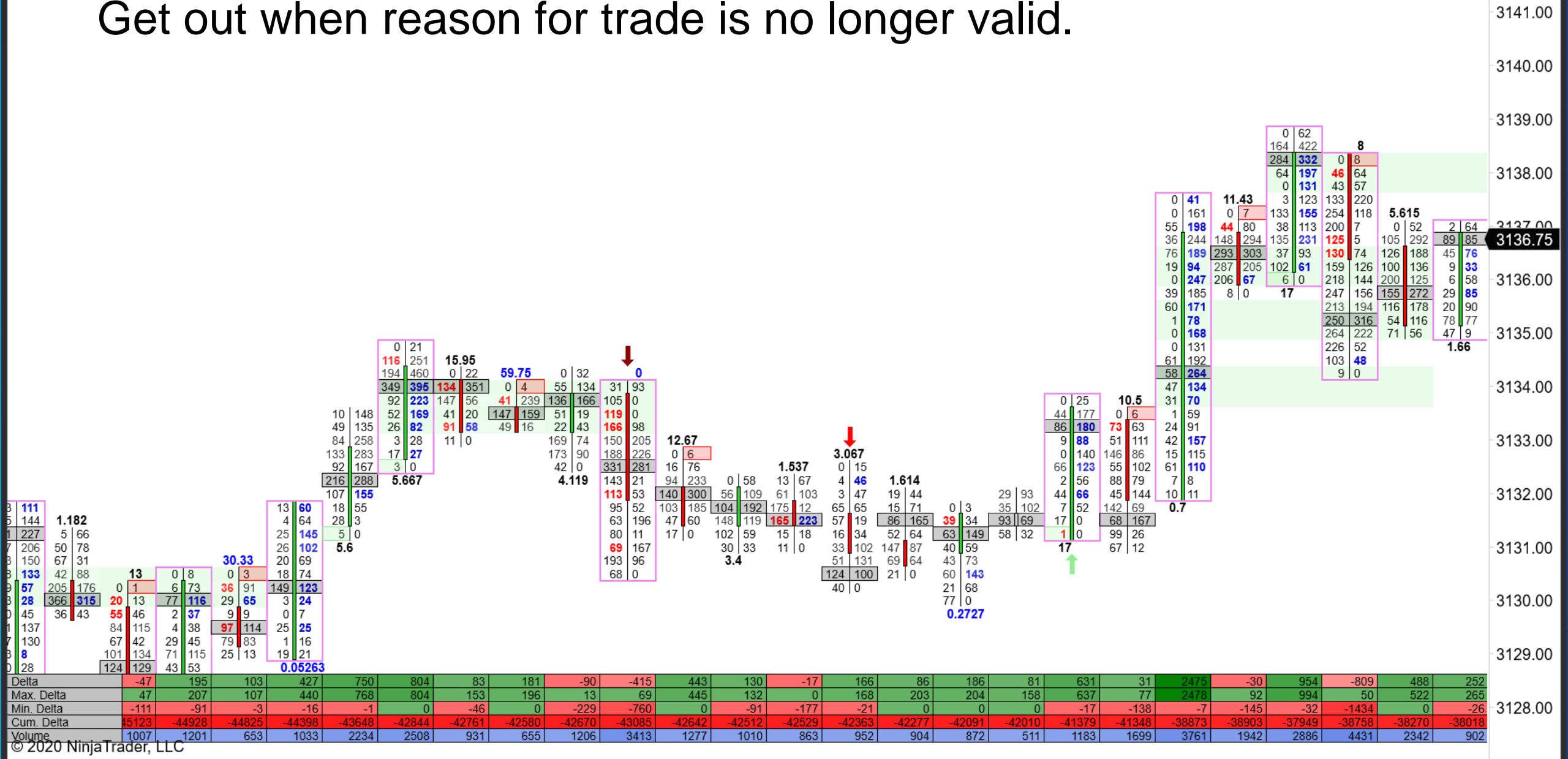


Reasons for getting out of a trade early for a loss:

2. The original trade reasoning is invalidated. For example, if the reason for the trade was to buy a stacked imbalance, but the market is unable to remain above the imbalance, get out. If you short because of a bearish prominent point of control that you think is resistance and the market rallies up to and above the bearish prominent point of control, get out. Order flow gives you very precise reasons for being in a trade. As a result if the trade is not working as expected, get out.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))
7/9/2020 11:41:00 - 7/9/2020 12:07:00

Get out when reason for trade is no longer valid.

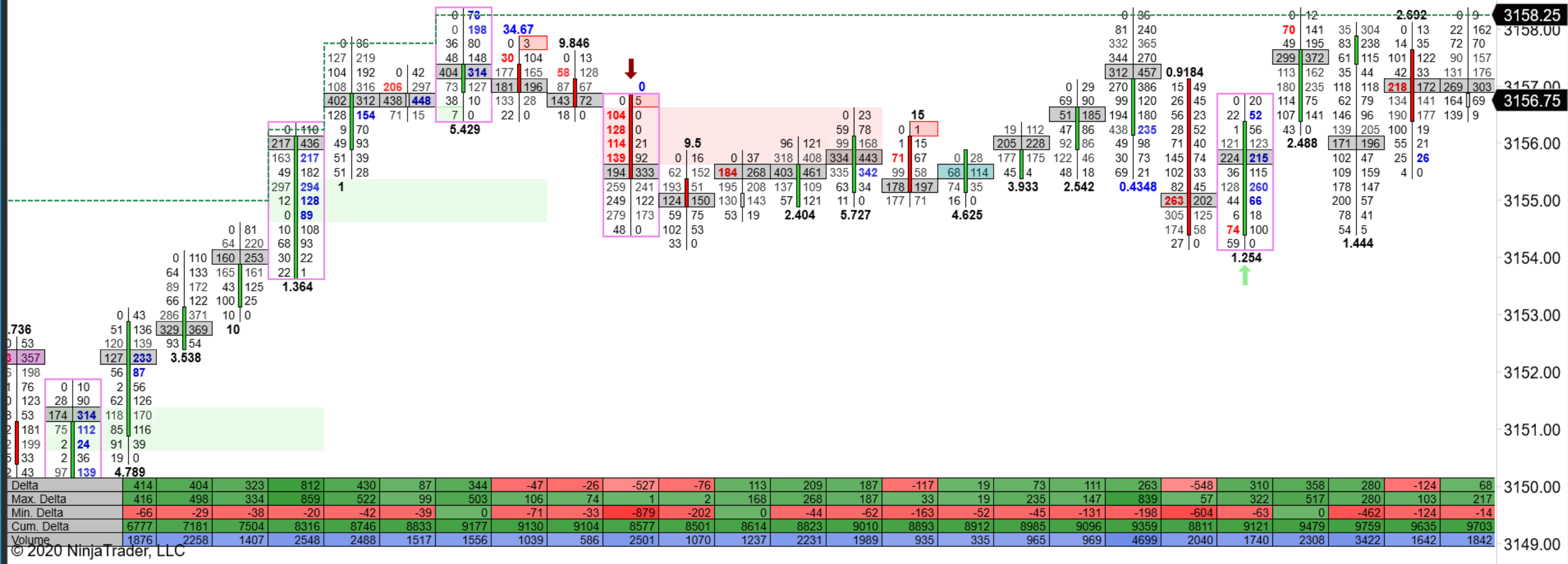


Reasons for getting out of a trade early for a loss:

3. Time decay. The longer you are in a trade that is not going in your favor (neutral stage) the reason for taking the trade is wearing off. Many traders will remain in a trade that is not paying them in hopes of the trade eventually working out.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))
7/10/2020 10:37:00 - 7/10/2020 11:03:00

Time decay – as trade goes on and market doesn't move new order flow comes in that may change market sentiment.

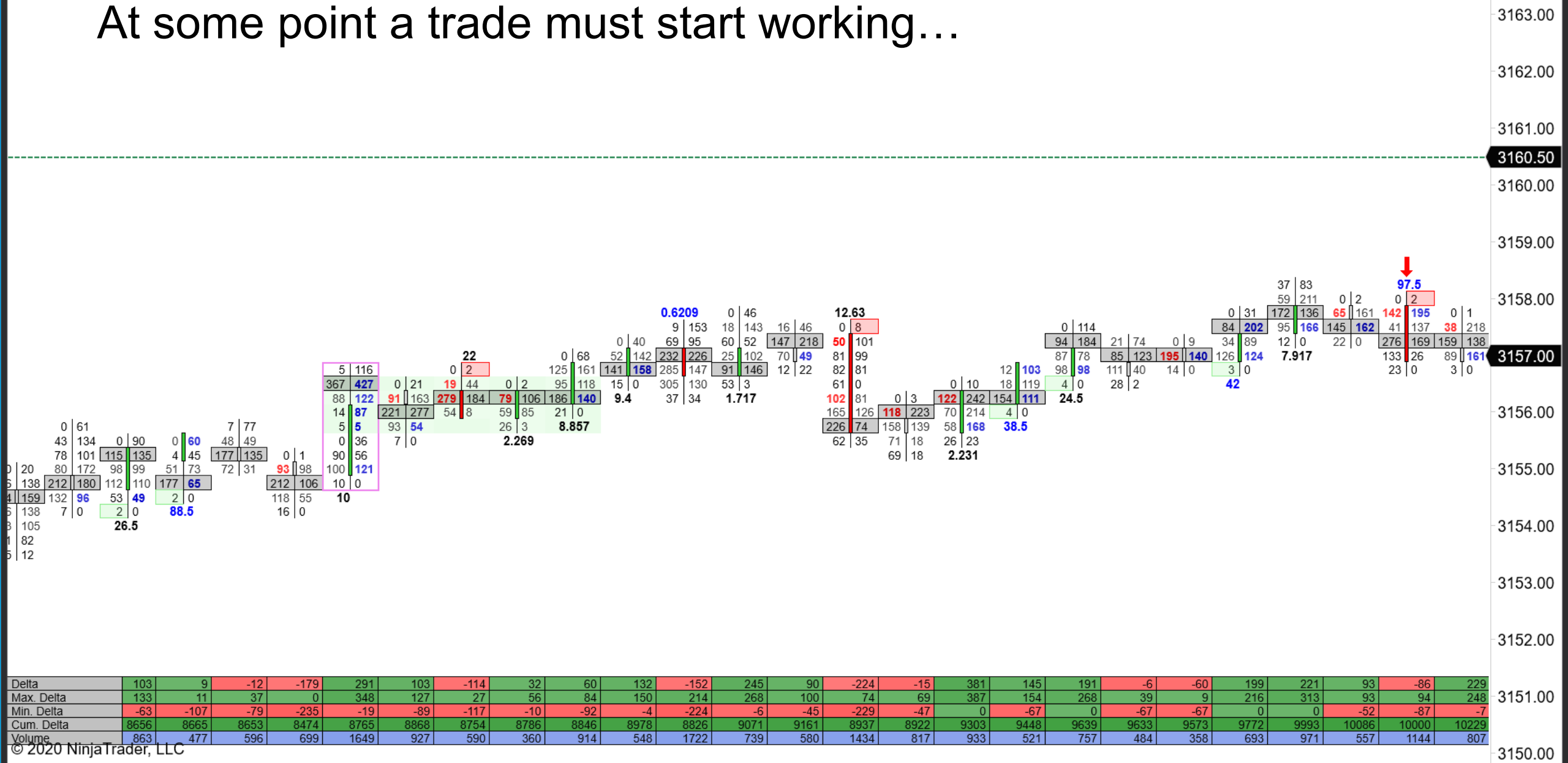


Just about every trading method or strategy is concerned only with entry and exit but not with what happens in between entry and exit where things can continue as expected, do nothing or change drastically.

Most traders think of risk only in terms of money, but there is a time risk as well. Time risk is a self-imposed risk by the trader in the form of active trade management.

Order Flows Trader(MES 09-20 (1 Minute)), Current day OHL(MES 09-20 (1 Minute))
7/10/2020 11:46:00 - 7/10/2020 12:12:00

At some point a trade must start working...



Every trade that you enter into has life cycle. From the moment you enter into a trade to the moment you exit the trade, conditions are constantly changing, either in your favor or against you. The longer you are in a trade the higher the chance something can happen that can change the market conditions. Time is a risk factor. The life cycle of a trade is imposed either by the trader or the market.

If you struggle getting out of bad trades, run through a mental checklist of the pros and cons of remaining in the trade. If there are more cons than pros, then simply get out.

There are always plenty of opportunities to trade every day. Sometimes sitting on your hands is the best trade you can make.

When managing the risk of time a trader must be monitoring the current market situation and ask:

- Is the order flow continuing in the direction of the reason for getting into the trade?
- Has the order flow changed direction? Neutral? Bullish to bearish? Bearish to bullish?
- Is the market doing what is expected or behaving differently?

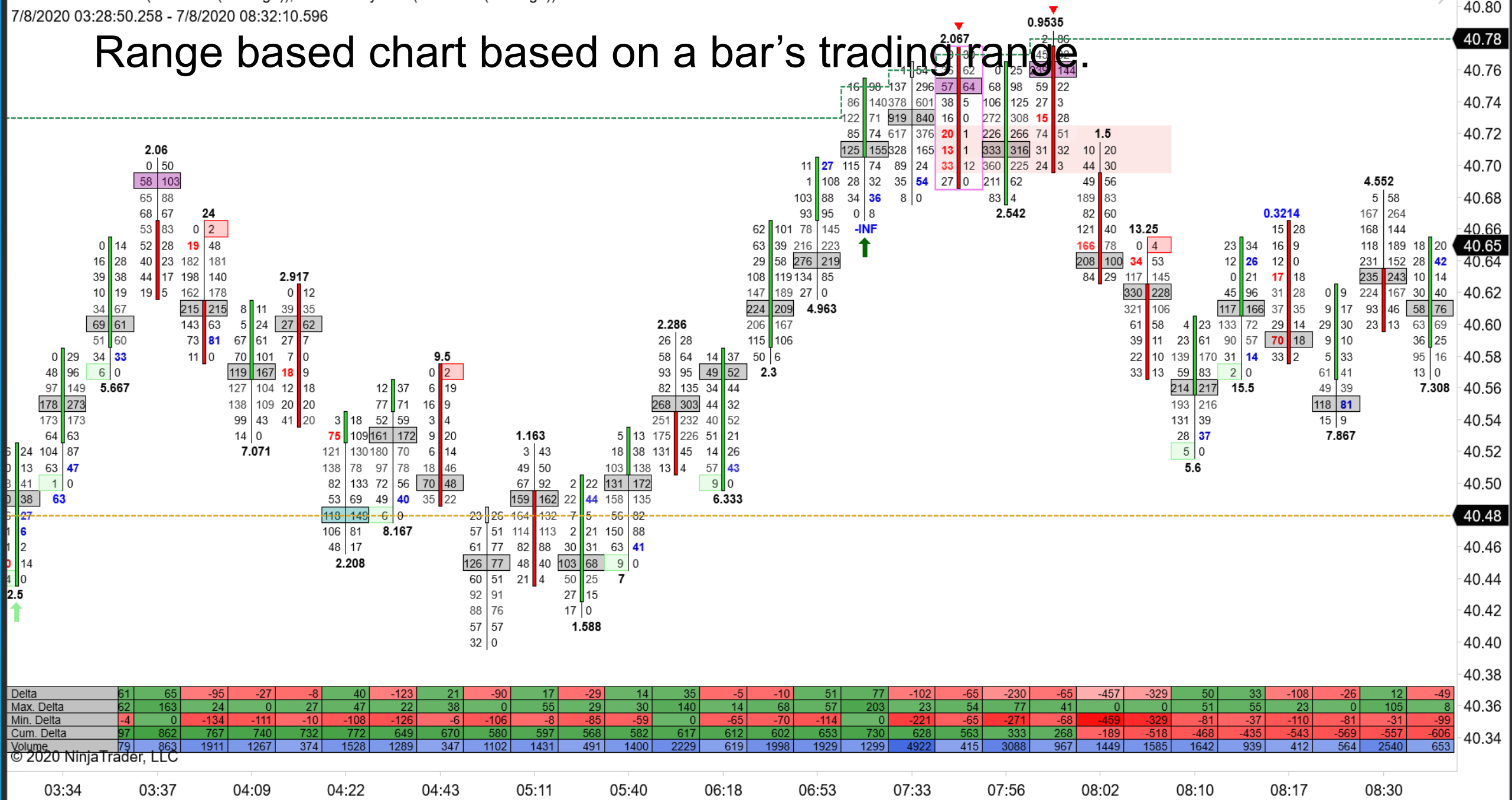
How does a trader consider the time risk of a trade?

For example, you buy CL expecting the market to go 50 cents higher. Over the next hour CL only goes 15 cents higher and then continues sideways. You were looking for a 50 cent move but only got a 15 cent move and now there is no more movement. Do you get out and book the 15 cents or move your stop up to break even and just let the trade continue one way or another?

Traders often try to get around the time factor by using charts that remove time from the trading equation and essentially eliminate time risk by using range-based charts, volume and tick-based charts, and a few others.

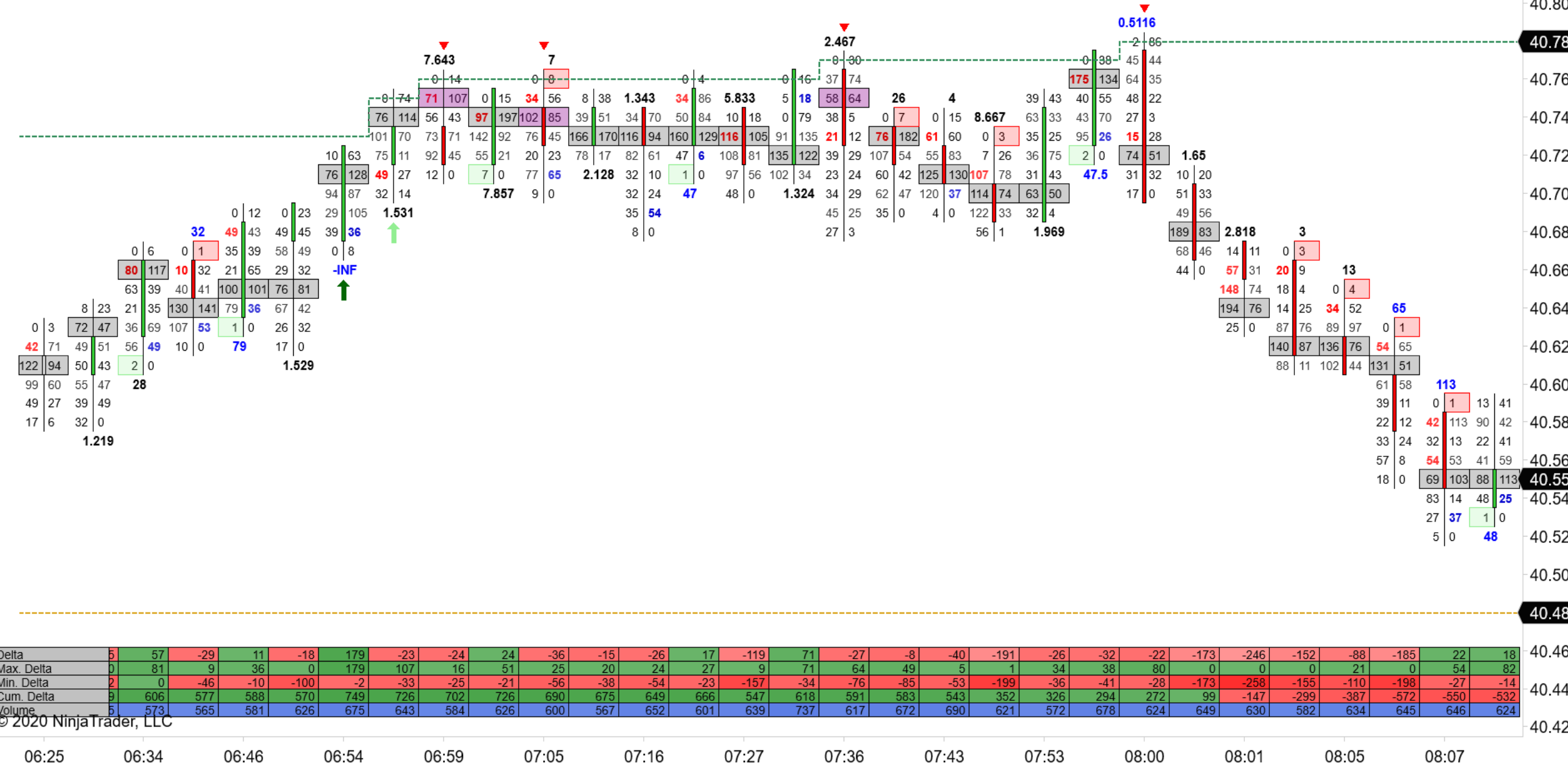
Is that good or bad? The answer: It depends. There is no one perfect chart, but there is a chart that suits you and your trading style.

Range based chart based on a bar's trading range.



Order Flows Trader(CL 08-20 (500 Tick)), Current day OHL(CL 08-20 (500 Tick))
7/8/2020 06:25:45.309 - 7/8/2020 08:09:38.485

Tick based chart based on the trades in the bar.



7/8/2020 07:40:39.371 - 7/8/2020 09:13:40.374

[illegible]

07:46	07:59	08:03	08:08	08:16	08:25	08:32	08:38	08:45	08:55	08:59	09:04	09:09
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Which chart to use is a personal choice based on your own risk tolerance.

There is no perfect chart. But there is a chart perfect for you.
In trading nothing is one-size fits all.

Event risk is something completely out of the control of the trader in terms of risk, but a trader must still be aware of it and protect himself from it. Event risk has nothing to do with what you plan for, but you still have to plan for it. For example, in soccer it could all of a sudden rain which would change the footing on the pitch. It is an external event you have no control over.

Trading systems generally don't take into account event risk because they are built on large data sets of data occurrences.

Recently a form of event risk that affect many traders is rise in margins both at the exchange level and broker level (the ones who offer day trading margin rates). In some cases traders were forced to liquidate positions that they couldn't afford. This is a form of event risk. Something out of your control.

What is more important? Trading method or trading psychology? Some people say psychology is more important than having a good trading method. But I think that is perpetuated by traders who don't have a profitable trading method. Think about it for a moment, if you are a profitable trader doesn't that give you a psychological edge over other traders?

Miscellaneous stuff

People who talk about discipline, more often than not, have never traded day in and day out. Telling a trader that they must be “more disciplined” just shows that the person saying it probably hasn’t traded. The market is cruel and if you are not disciplined, it will crush you.

What you need to do is develop discipline. Its like learning to drive a car, we all want to go fast. There are times when we go above the speed limit, but we know how to exert discipline to keep us safe.

Differences between trend days up and trend day down.

On trend days up, markets react less from its intraday highs than it does from the lows on a trend day down.

On trend days down, markets can have bigger reactions from it lows. Give positions a little more room.

When a market is trading inside the day's range, to maximize your trade you should look to areas where the market can go and to areas where the market may run into support or resistance.

Most traders have a TP and SL. But if your TP is beyond an area where the market may not get to, then you must understand that and adjust accordingly.

Why do you get into a trade to begin with? Often it is because you have seen some kind of pattern develop in the market that you have seen before and traded profitably. But what happens when you get into a trade and then the market just goes against you from the onset? Are you just going to let it stop you out or are you going to bail out of the trade early because you recognize it is a lost cause. Think of chess, a chess master can tell long before the game ends if he is going to win or lose.

This concludes Module 10. In Module 11 we will discuss how to use order flow to let winners run.