Markets wobble and my stop-losses are too close to my opening level – so I get wiped out.

The following week I have to go to America and will rarely be anywhere near the system during trading hours. The only sensible thing to do is to hedge existing positions – which, again, means going short on sharemarkets.

TUESDAY September 27, 2011

My week in America, attending the World Bank/IMF annual meetings, is an apocalyptic series of news conferences and meetings of leaders who are supposed to bring the world away from the threat of recession and euro zone collapse. To say they don't inspire much confidence is like saying the Titanic had a slightly disappointing maiden voyage. The markets, unimpressed, crash; the Dow loses almost 400 points on the Thursday.

So with my short positions on world sharemarkets, I must have made a fortune, right? Wrong. Although my call on stockmarkets declining was entirely correct, I manage instead to lose half my money because I failed to take into account volatility. On the way down, markets bounce and wobble and my stop-losses are too close to the level at which I bought – so I get wiped out, despite actually having been right.

Seeing this, I then go short again, with a wider stop-loss, and this time I eventually get it right. By the end of the month, and the end of my four-week trial, I'm just short of where I started.

It takes some kind of incompetence to go short during a market rout and still lose money. But I've learned some valuable lessons and am newly convinced of the merits of CFDs. Were I to start from scratch with real money, having learned about the pitfalls, I think I'd do reasonably well.

Postscript

Since the money isn't real, I don't close out the trades on the day I stop trading to file this article. I see what they're worth that day, take that as my closing balance, and leave them. Two weeks later, out of curiosity, I open the system again. The markets have rallied and all my capital has been wiped out.

Of course this isn't real, as in reality I would have closed the positions when I wanted the money. But it's a cautionary tale: never leave your positions unmonitored! **Si**

SO WHAT HAVE I LEARNED?

- Spend a month paper trading! You may think you know what you're doing with a new system but you're very likely to find a couple of areas along the way where you'll misstep because you're unfamiliar with the program and its processes. There's no harm in taking a few weeks to get to know the ropes.
- Know your strategy. It may be, for example, that you want CFDs to hedge your stock exposure, or to take a position on particular asset classes where normally you can't get exposure. But don't just dip in and out like it's a sweet shop – know what you want to do and execute your plan calmly.
- Stop-losses are great. It would be rash to use CFDs without them.
- But be careful where exactly you put those stop-losses. On three separate occasions I took a position that, within a week, was correct but still lost money because my stop-loss was hit during volatility.
- Be sure your understanding of leverage, margin and exposure is correct. This is another thing I got wrong to my (theoretical) cost, taking much more leveraged exposure on a foreign exchange position than I intended to. No harm done in paper trading – that's what it is for, to iron out the bumps – but you wouldn't want to make an error like that in real life. Leverage on FX contracts can be very, very high.