

# Trading Systems Series



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## OBJECTIVE TRADING STRATEGIES VS. MECHANICAL TRADING SYSTEMS

### What is an Objective Trading Strategy?

An objective trading strategy is essentially your individual approach to the market; it is not a strict set of trading rules or a software program. It encompasses such aspects as how you enter a trade, how you exit a trade, money management, and psychology. An effective trading strategy will supply you with an entry method that gives you an “edge” in the market. This trading edge is what you watch for when analyzing the markets, you ideally want your trading edge to provide you with a win percentage of 50% or better. There are certainly is no shortage of trading “edges” available on the internet for you to pursue, however, this is where you must be careful because the majority of these entry methods are simply too confusing, expensive, or rigid to be effective.

Successful traders operate with a clear mindset that enables them to make objective trading decisions. This objective mindset is not something that can be developed overnight however, for most traders it takes years of trial and error and lost time and money before they discover how to obtain an objective trading mindset. The specific trading strategy you use has a huge influence on your trading mindset. If you are using an overly complicated trading strategy that makes your charts look like a piece of modern abstract art, how do you expect to maintain a clear and objective mindset? The best trading strategies are born of simplicity and should complement and induce clear and objective thinking patterns, not inhibit them as so many trading strategies do these days.

### What is a Mechanical Trading System?

A mechanical trading system is typically used to describe strict rule-based trading approaches that can come in various forms. Some of the more popular trading systems include those that make use of lagging indicators and those that involve software programs or proprietary programmed indicators. While some



of these systems do indeed bring profits to traders for a period of time, there is an inherent flaw with most of these trading systems.

The flaw with many mechanical trading systems revolves around the fact that they are based on the principle that you must take every single trade signal the system provides for you, otherwise the “edge” that the system provides will in effect be nullified. Many traders are drawn to such rigid trading systems because they claim to fully automate the trading process and thus take away the possibility of making emotional trading mistakes. The one big secret that you will never hear any website selling a trading “robot” system or a lagging indicator based system is that you still have to enter the number of shares you want to trade. This means you are still in control of how much leveraged risk you use on each trade and thus still have the capacity to commit emotional trading mistakes. Put simply, any advantage that strict rule-based trading systems have over more discretionary trading strategies is eliminated by the fact that you still must manually enter your position with the fact that there is no flexibility built into the actual trading entries and exits.

A close friend of mine worked as a systems consultant and would often get requests for “completely automated” inventory and manufacturing systems. To this request she would caution all her clients. A completely automated system uses only rules, and does not use common sense. It also doesn’t use checks and balances that we, as humans, have inherent in our thinking. A completely automated system may say BUY BUY BUY. Without the check of a human being who knows that circumstances have changed, a company could go out of business. Likewise, in the markets. A system being adhered to 100%, in an automated computer like fashion does not read the USA Today and know that certain economic factors will likely effect the stock tomorrow. It can’t actually put 2 and 2 together the way a human brain can. Systems are great as rules, but a little human element to provide a check and guidance to the system is much better.

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