

Understanding the Drawdown in Automated Forex Trading Systems

By Winsor AGA Hoang

Michael Jordan was one of the best basketball players in the world. So what do Michael Jordan and automated Forex trading have in common? It is known in sports terminology as a cold streak or slump. Michael Jordan has missed more than 9000 shots in his career. He and his team have lost almost 300 games, and he failed to make the final game winning shot more than 25 times in his career. Does this make him a poor basketball player because he has failed over and over again during his career?

An athlete will go through a losing streak, and every trader will go through a similar losing streak, a period of consecutive losses with no profitable trades. In trading, this term is defined as drawdown, and it can be defined as a percentage or a number. Regardless of whether you are trading manually or using any automated Forex trading systems, you will experience a period of consecutive losses. It does not matter if you are Michael Jordan of the basketball world or the Warren Buffett of the investment world, everyone will face losses during their career or investment period. Losses are inevitable, and as investors/traders, we cannot avoid them. Trading involves both risk and reward; hence, it is impossible to obtain any type of reward without involving some risk.

An automated Forex trading system cannot avoid a losing streak; however, it is with proper money management that it can minimize the losses during the cold streak. For example, if an automated Forex trading system has a maximum drawdown of \$3,000 using a 0.1 standard trading lot, it is not advisable to start trading with this system using \$5,000 as starting capital. If you are unlucky and a drawdown immediately starts right after you have turned on your automated Forex trading system, you will see your trading account going from \$5,000, to \$4,000, to \$3,000, to \$2,500 and then to \$2,000. In this example, you just experienced a losing streak of \$3,000, or a 60% drawdown.

Before using any particular trading systems, you want to know what is the largest loss you can face when an automated Forex trading system starts incurring losses due to changes in the volatile Forex market. You must understand that this is a temporary worsening condition of a trading system. This period is the trading risk, and it will pass. With this risky period, a good trading system will recover and provide you with ample rewards (a.k.a. profits). Depending on your level of risk tolerance, a 60% drawdown is quite extreme in one's trading account. If you know that the drawdown is \$3,000, you may want to start trading with \$10,000 instead of \$5,000. During a losing streak of \$3,000, you will only experience a drawdown of 30%, which is a lot more tolerable.

Be a good investor scout and always prepare for the largest losing streak during your investment period. A drawdown period can be as long as three months; hence, don't jump from one system to another system looking for the Holy Grail. If you have found a profitable trading system, stick with it during its three months drawdown period and you will be handsomely rewarded for your patience. Alternatively, follow a profitable automated Forex trading system and wait until it starts losing and then jump in. Just like

Michael Jordan of basketball, after missing three baskets, he will likely score on the fourth basket, so don't give up on him too early.

Winsor A.G.A. Hoang is a registered Professional Engineer and the founder of <http://www.ctsforex.com>. He has developed 5 managed Forex trading systems for auto trading. His automated software is internationally ranked with live trading results published every 30minutes. Visitors can use the published trading results as free Forex signals.

Contact: Winsor A.G.A. Hoang
winsor@ctsforex.com
Winsor Global Financial Inc.
4007 Knight Street
Vancouver, BC,
Canada V5N 3L9
Tel No: 604-603-1889
Fax No: 604-876-2205
<http://www.ctsforex.com/>