ReadySetCrypto Futures Masterclass

Module Two: How Do You Trade Futures for a Profit?

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Table of Contents

Introduction - Trading Futures for a Profit

Seems like making money should be a fairly straightforward thing when trading futures, right? How hard could it be? Buy low and sell high when you're long the contract, and sell high/buy low when you're short the contract. Find a long signal and go long, or find a short signal and go short. Close the position, pump your first in the air and yell "I ROCK!!!!"

If it were only that easy. And in a way, it really IS that easy, however in practice it gets more complicated because humans are not simple beings. In fact, our decision-making process is *irrational* and this will affect every trade that we place, especially those trades that place live capital at risk. (This is why simulated trading results are so different)

Longer-term swing trading or outright hodling tends to smooth out the human responses from traders; if a long-term "value" entry doesn't immediately work out, most investors just shrug their shoulders and make some comment about "being in it for the long run." But short-term futures trades are typically ones where we know the outcome within seconds or minutes, not hours or days….and as a result of the compressed timeframe and inherent leverage of the instruments, tends to make futures trading somewhat of an "edge of the seat" experience for most.

But futures trading is…*different*. There's not a style of trading that can create results so quickly, both good and bad. Let's see what the factors are for making a profit:

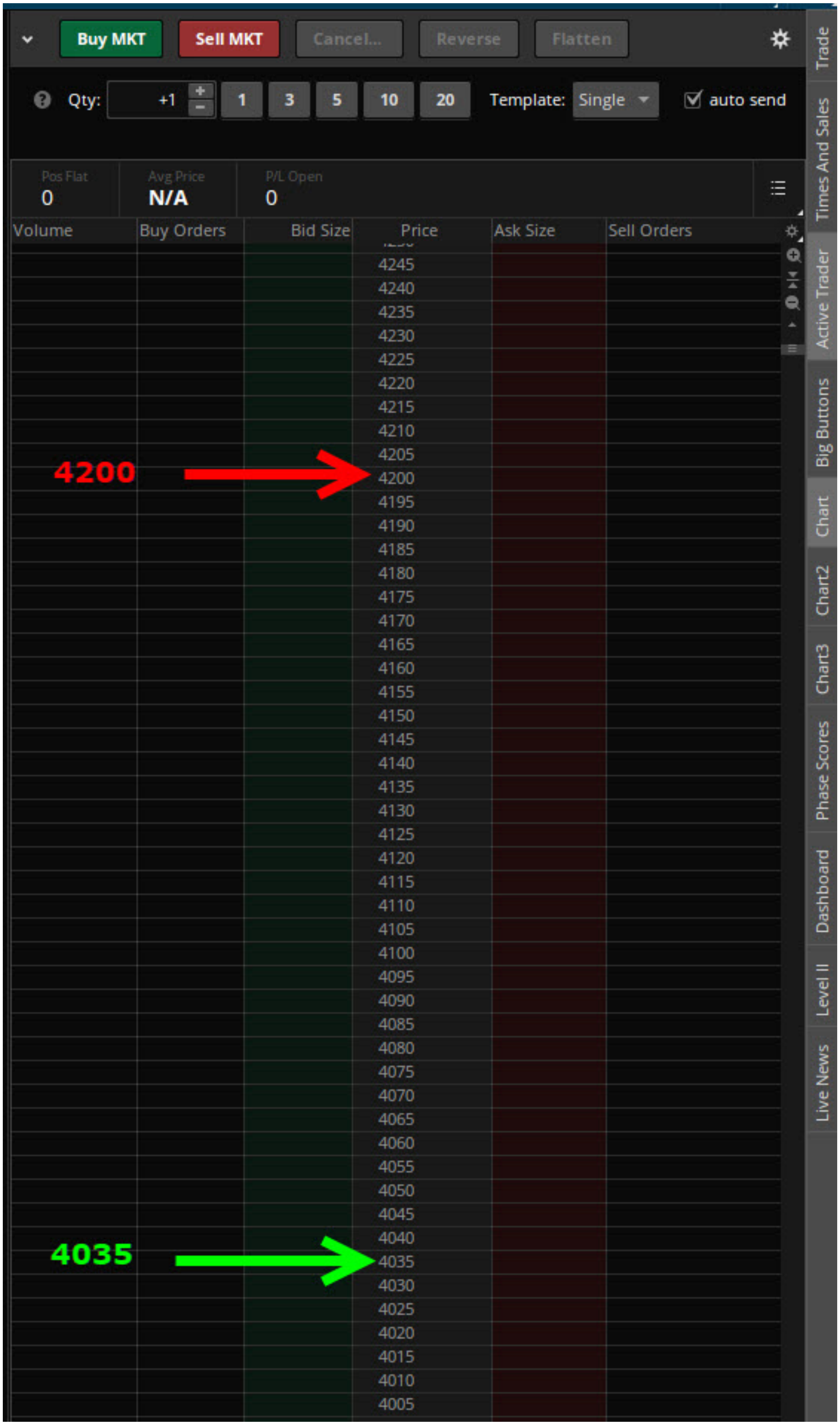
The Mechanics of Making Money With Futures

Let's walk though an example of a trade setup and show how this might make money for us.

Imagine that we have a trade setup below, which is calling for a long entry at BTC/USD $4032. Let's compare entering this trade with BTC "spot," vs. /XBT futures from the CBOE, vs a 1BTC leveraged position on PrimeXBT futures.

And let's say that we sell out of the trade at BTC/USD $4200. First off, if we were trading the SPOT currency with a total of ONE Bitcoin position size, our profits would be ($4200 exit minus $4032 entry) or $168. But it takes one whole BTC of position size to make that return, which is good for $168/$4032 or 4.17% return.

OK, not bad, a 4% return is nothing to turn your nose up for. Now let's look at using the /XBT futures contract which is trading on the TDAmeritrade platform. As we know, the leverage behind these contracts is $5/tick. Let's show this on the ladder interface: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Template: Single
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Avg Price N/A
P/L Open 0
Volume
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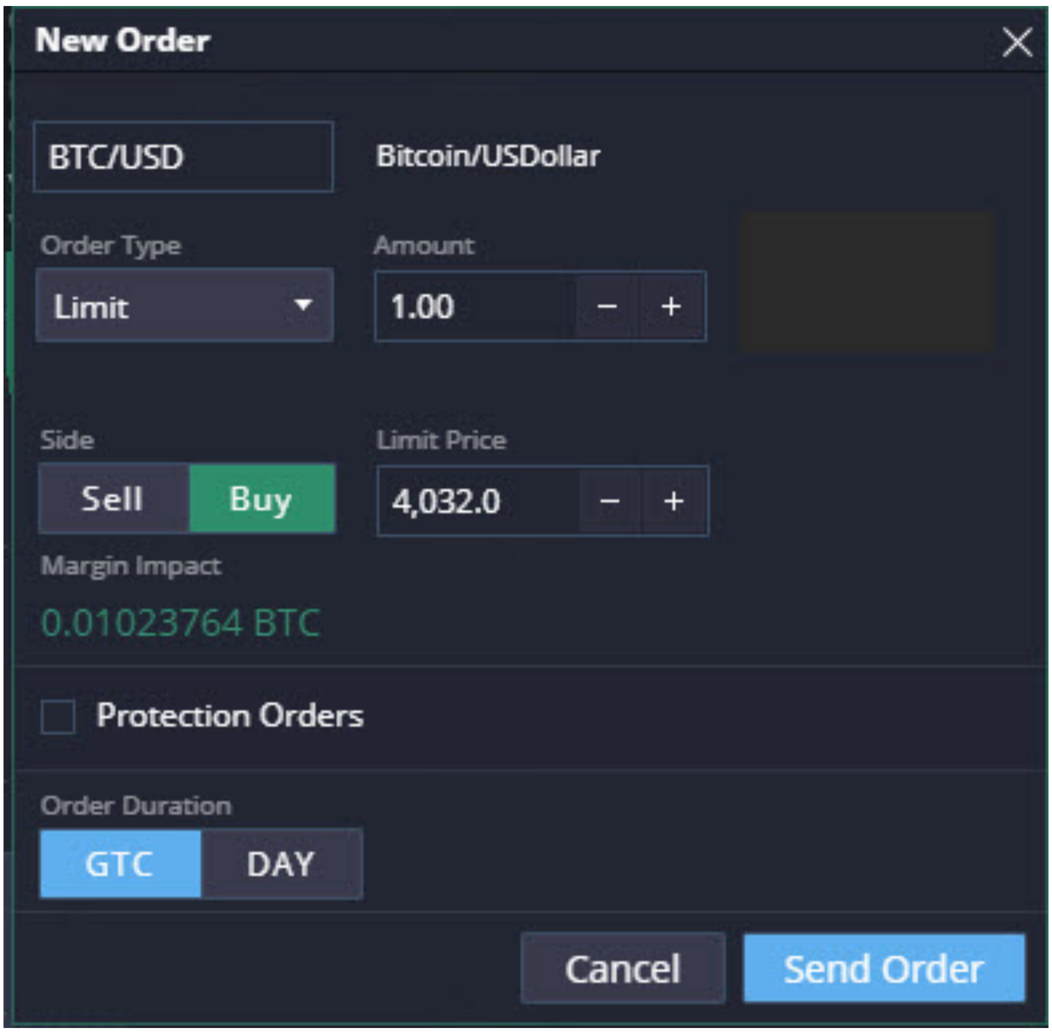
Note that I could not enter at the $4032 price point like I could with the spot currency, since the price moves in $5 minimum "tick" movements. My profit using this futures contract was ($4200 - $4035) or $165. Another way to calculate this is that the price moved 33 "ticks" up the ladder, with each tick being worth $5 in value to me since I was long the contract. Our return % would be the $165 divided by (initial margin).

Now let's look at another broker that does not use actual "futures" but more of the "perpetual swap" variant, this time with 100x leverage. Note that we can specify the limit order of entry price, at this point we are using the $4032 entry point and don't have to "fit" the price into a tick, so in this way it's similar to trading the spot currency.



Note that we are synthetically using the leverage of 1BTC, in the "Amount" field. That means that the position will gain and lose money as if we were trading one full bitcoin. Note the margin impact, however….the trade only sets aside 1/100 of that 1BTC value as the necessary capital to start the trade. This allows us to use far less capital to initiate the trade, versus the $4032 of capital necessary to leverage 1 BTC of the spot currency.

In this case, if we also traded out of this position at BTC $4200, we would also earn a profit of $168 ($4200 - $4032) yet we only had to use .01 BTC as margin, or the equivalent of $42. Our profit on margin was $168/$42 = 400% return!

Now don't get carried away to think that you only needed a $42 balance in your account to set up the trade, which is true…yet just not realistic.

First off, the price could have just as easily gone the other way. As soon as your account balance dropped below the INITIAL MARGIN requirement, you would have been stopped out by the broker on a margin call. And even if you did have the balance to absorb a drop in price, let's say you had an effective balance of $200 to start the trade….then that "leverage" knife cuts both ways, so someone setting up a SHORT position at $4032 instead, and then stopping themselves out at $4200….would have lost $168. On a $200 account, you've effectively blown it out on one trade alone.

Module Six will focus on managing risk so we can set up the correct parameters not to blow out our accounts on one trade.

And this same example could have been set up to the short side, as futures contracts work exactly the same (in most cases) to the downside. They are ambidextrous, which is one of the points of trading them.

So that's how we make money with futures contracts. Simple, right? Well, the concept is simple. Making the right trades to earn a profit is tougher. And not giving back your profits is the toughest thing of all. Let's talk about that for a minute….

It’s Not What You Make, It’s What You Keep

There is an everlasting impression in trading where the vast majority of participants will focus on the “get rich quick” side of the business….”*look how much I can make with this trade!*” Brokers and online marketers exacerbate the issue by focusing on how fast leveraged gains can make for you if the price goes in your direction.

But….no one wants to talk about the “dark side” of trading, which is “*how much can I lose on this trade?*” This very question separates the professionals from the amateurs. Amateurs focus on how much they can win, professionals focus on how much they might possibly lose first before they ever consider the upside on the trade.

Sooner or later you’ll find out that the competition, or the “professional trader,” is one that begins the discussion before any trade by asking “*what is my risk?*” And why is this? Because trading capital is the lifeblood of any professional trader. No capital, no profits, no business.

But for most amateur traders, trading futures is just a hobby, something they refer to as “*when I get good at this I’ll quit my job*.” The problem with this statement is that until this trader begins to focus on risk management, they will never really get “good.”

The topic of Risk Management is usually not the first one that the newer trader reaches for, however. It’s usually an “I’ll get to that one later” topic. It doesn’t have to be that tedious nor oppressive; in an upcoming module I’ll show you a few simple techniques that will keep you on the right side of Risk.

It’s also my experience that most traders will reach a certain level of competency and success, where they’ll reel off several winning days in a row, to the point of euphoria! And then, out of the blue….one day creates a “distribution” and all of it goes back into the market. This is usually an issue of self-control and discipline, if the trader goes into “revenge” mode trying to punish the market for the last loss. It usually does not end well and can be extraordinarily frustrating. This is beyond simple risk management, and into the realm of how the subconscious mind reacts to stress and risk.

There is only one very narrow path to success. I’ll do everything that I can to show you the way, but you need to take your own footsteps on that path.

What is Your Trading Edge?

A newer trader will often assume that all that you need to do to make money in any market is to employ some type of technical strategy, plug it into that market, and sit back and enjoy the profits. This is why those running trading bots during the Bear Market in 2018 generally blew up their accounts because the majority of the strategies are made to trade long-only, and bull markets have different movement and "character" than bear markets. Thus, there was no "edge."

What is "edge," you ask?

I hesitate using a gambling analogy but it's instructive here. Who has the "edge" in a casino? The house, of course. Every game has a very slight probability edge in the favor of the casino, regulated by either the odds of the game as designed, or by mechanics/software.

If you just take the same attitude of pulling the one-armed bandit in a casino as you do with a trade, then the same skewed outcome awaits you. The odds of the price going higher or lower in the future are a coin-flip probability, 50-50. But over time, the friction caused by broker commissions will cause a steady erosion of trading capital. The broker always wins as evidenced by BitMEX' lease of the most expensive office space in Hong Kong.

Here's why I don't like gambling analogies when describing trading; having an edge is illegal in a casino! If you're caught counting cards in a blackjack game, you'll see the curb before you'll see your next hand. And with facial recognition technologies, that will be your last hand - ever - at that casino. No edge allowed, play by the probabilities designed into the game.

But trading is different; you're allowed to secure just as much EDGE as you can possibly fit into one trade, when you're a retail trader.

At this point you're probably asking, "*OK, how does one go about gaining an edge in trading?*" Good question, and one that we'll define when we get into a future module with Trading Systems. But a very general answer is "by trading opposite of the investing herd that are making decisions with their emotions." And those decisions cause pain, which is what we need to discuss next…

For Price to Move, Someone's Gotta Be In Pain

Stop and think for a minute, WHY does price actually move up and down?

At this point most investors will answer with either an Adam Smith definition of supply/demand economics, or a tedious explanation of how whales and OTC exchanges manipulate the price. In reality it might be a little of those, but not as much as people expect.

The driving force in markets has always been, and will continue to be EMOTIONS like Fear and Greed. And of the two, *fear* is the more powerful emotion and accounts for much of the movement that you see day-to-day or even minute-to-minute. And if we can anticipate those conditions that cause fear/greed and emotional reactions, then we can create a system that takes advantage of these predictable emotions.

Yes, if you think that it all sounds very Machiavellian, you'd be correct. Financial markets have a very low barrier-to-entry, meaning that anyone can get in, regardless of experience. And thus begins the "financial food chain" of life, as those low on the experience scale become the "chum" that others feast upon.

The pain comes into markets in a couple of ways:

- **A stop-out in a declining market:** Let's say that you went "long" some asset, and the price ends up going lower and lower and lower, and eventually hits your "stop" order. A "Stop" is actually a "Market" order, and a flood of market orders hitting at the same time will actually cause the price to move very rapidly to the downside for a short period of time until the market balances again. That flood of "pain" where stops are being run causes price to move in a rush.
- **Chasing a runaway market:** Price is screaming to the upside and you're on the sideline. The pain of watching a market run away without you is actually stronger than an actual stop-out. You finally can't take it any longer and enter at the top of the market, after which it instinctively drops like a stone as the very last longs have entered. The pain is doubly intense now as you stop out of the position.

Pain moves the markets, more so than anything else.

Here's something that I want you to tape to your office wall:

The very best trade setups that you will take will feel horrible to enter. Conversely, the best-feeling trade entries will rarely ever work.

Start to learn to trade to the opposite side of what you feel is right, at the beginning of your journey. Eventually you will learn to think like a contrarian if you are to create "edge" and build a successful trading business.

Ready For Your First Surgery, Intern?

Think about this one for a minute…an MD studies for four years in undergrad studies, four years in medical school, and anywhere from three to eight years of internship before they are considered ready to practice medicine. (Actual MDs will probably write in and correct me on my timeline here, but I hope you get my point) It takes over a decade of specialized education and applied practice before a doctor can do some carpentry on your hip, and even more time than that before they can probe your cranium.

Traders? We want to set up and fund an account TOMORROW to get trading. Time is money, right?

The very real probability is that you will end up funding someone else's account, if you stumble into this process like so many do. Profitable trading is certainly one of the most difficult, yet rewarding things that I've ever done, yet it has been a journey over many years before the process "slowed down" for me.

Am I saying that you also need the better part of a decade to be profitable? No, but again there is only one very narrow path that I have seen be successful. And one of the things that you'll have to do is to re-teach yourself the concept of "risk."

What do YOU think of when you hear the term "risk?" Bad things, right? The word "risk" carries with it almost universally negative connotations. And we've heard warnings about risk our entire lives:

- "Don't play on the freeway! You'll get hurt!"
- "Wear a helmet when you ride your bicycle, you'll get hurt!"

Our entire lives we associate "risk" with "pain," yes? So what happens when you put capital at risk in a trade? The same thing! Sure, we want to MANAGE our risk, but we have to willingly let the trade do what it's going to do without sweating over every tick in the price. This goes hand-in-hand with my module on Risk Management as I show you how to size a position below your "pain radar."

But some people cannot let it go, and view capital "at risk" in the market in a very protective way. Understand that without RISK, there is no REWARD. You get paid for taking on risk in the market, and successfully navigating it in your favor. Do NOT look for a "risk-less" strategy because it does not exist…actually it does, but it's called a Passbook Savings account at your local bank, paying about 1% APR.

And that carries risk of a different type.

Summary - Trading Futures for a Profit

Many traders new to this space of actual “trading” (and not just hodling) think that trading is an easy path to daily income and riches. On paper, there is some level of truth to that. Once we filter those ideas through the irrational human mind, it takes on a whole new level of challenge.

In this module I showed that we can trade “long” or “short” for a profit, if we are long when the price goes higher, or short when the price drops. Sounds easy, right?

But there are many things that conspire against us to KEEP those profits.

The rest of this program is going to be dedicated to giving you structure that you can build around, such as:

- Defining how to put all of this together in a plan (Module 3 Framework)
- Defining your specific trade specialty (Module 4 Trading Niche)
- Examining a potential trading methodology (Module 5 Trading Systems)
- Learning to manage risk (Module 6)
- Adjusting your strategies when volatility changes (Module 7)
- Showing how to trade on specific futures brokers (Module 8)
- How to create the optimum trading mindset (Module 9)

It really does take a full bat-cave full of tools and skills to be able to trade any market up and down for consistent profits. As I say so many times, “trading is a fairly simple venture, but we find ways to complicate it.”

It’s simple to the newbie, who complicates it and makes a mess of things, which then takes experience to tear down the rubbish and simplify things again.

Homework and Next Steps

Please complete the following tasks before moving to the next module:

- [ ] Watch the associated video for this module.
- [ ] Take the module quiz.
- [ ] Have you ever felt anxiety in the middle of a trade?
- [ ] Have you ever exited a trade at the very top or bottom of a move, taking a loss?
- [ ] Have you ever been very confident about the entry of a trade, only to watch it change course almost immediately after your entry?